THE ELECTRIC SUPPLY AND TRANSMISSION ACT OF 2001

HEARINGS

BEFORE THE

SUBCOMMITTEE ON ENERGY AND AIR QUALITY

OF THE

COMMITTEE ON ENERGY AND COMMERCE

HOUSE OF REPRESENTATIVES

ONE HUNDRED SEVENTH CONGRESS

FIRST SESSION

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THE ELECTRIC SUPPLY AND TRANSMISSION ACT OF 2001

WEDNESDAY, DECEMBER 12, 2001

HOUSE OF REPRESENTATIVES,
COMMITTEE ON ENERGY AND COMMERCE,
SUBCOMMITTEE ON ENERGY AND AIR QUALITY,
Washington, DC.

The subcommittee met, pursuant to notice, at 1 p.m., in room 2123, Rayburn House Office Building, Hon. Joe Barton (chairman) presiding.

Members present: Representatives Barton, Largent, Burr, Whitfield, Ganske, Norwood, Shimkus, Pickering, Bryant, Walden, Tauzin (ex officio), Boucher, Hall, Sawyer, Wynn, Waxman, Markey, Gordon, McCarthy, Strickland, Barrett, and Dingell (ex officio).

Staff present: Jason Bentley, majority counsel; Sean Cunningham, majority counsel; Andy Black, policy coordinator; Sue Sheridan, minority counsel; and Rick Kessler, minority professional staff.

Mr. BARTON. The subcommittee will come to order. If everybody will find your seat.

I want to welcome the four FERC commissioners that are confirmed and our Deputy Secretary, Mr. Blake, from the Department of Energy and our Commissioner of the TVA, Mr. McCullough. We are glad to have you folks.

Today, we start 2 days of legislative hearings on a comprehensive electricity bill, H.R. 3406. This bill is intended to be the subject of a subcommittee markup next week, assuming that Congress is going to still be in session next week, which more and more is beginning to look like a good assumption.

I want to ask our witnesses today and tomorrow to be forthright, to be specific when talking about the bill. This is a legislative attempt to balance all the various stakeholder interests that have been expressed in numerous hearings over, in the case of my subcommittee chairmanship, a 3-year period, and if you want to go back further than that, you could go back 7 years when Congressman Schaeffer was subcommittee chairman and did a number of hearings on this very same issue.

We have spent a great amount of time on both sides of he aisle in this subcommittee reviewing electricity markets this year and in years previous to this year. Major lessons that we learn again and again are part of the bill before us today. No. 1, we must increase, or at least put incentives to increase, the supply of electricity available to consumers. No. 2, we must improve the effective operation

of our transmission grid, and more and more that's on an interstate basis, not just on an intrastate basis. And No. 3, we've got to improve the capacity of our transmission grid.

Today, our witnesses are various Federal officials. We have the Deputy Secretary of Energy Frank Blake before us again, and we want to welcome you. We also have, as I said earlier, the four confirmed FERC commissioners before us, and we look forward to the day when the fifth one, Joe Kelliher, who used to be committee staff counsel, is also on your distinguished panel.

I want to also say that it's good to see Chairman Wood here as chairman. There are those today who are probably going to make it appear that Mr. Wood and I have some differences, and we may have some policy differences, but we have no personal differences. If I can be personal for a minute, I have known Pat Wood for a long, long time, and I remember three or 4 years ago he and I plotting to get tickets to the Sugar Bowl when A&M was playing Ohio State. So we go back a ways, and the best part of our relationship, Chairman Wood, is that the best days are ahead of us—you, as chairman of your Commission, and hopefully me, as chairman of this distinguished subcommittee.

Mr. WOOD. And we hope A&M will actually win the Sugar Bowl next time.

Mr. BARTON. It would be nice if the Aggies would win a bowl game in our lifetime. I would admit to that.

I expect that we are going to get many questions today about recent actions of the FERC, questions about Regional Transmission Organizations, market-based rates in connection with RTOs, the market power screen test, the suitability of transcos in an RTO future, things like that.

We also want to welcome our chairman of the Tennessee Valley Authority. We want to thank you for coming. There is a title in our bill that has been worked out with Congressman Bryant on the Republican side and Whitfield on the Republican side and Congressman Gordon on the Democratic side. I think it is a good title, and I look forward to what your concerns and comments are on that particular title of the bill.

Tomorrow, we are going to hear from the SEC. We are also going to have our usual number of stakeholder participants. And the problem we have is that we have got lots of stakeholders, and the table will only hold so many people.

I want to thank Chairman Tauzin of the full committee, Ranking Member Rick Boucher, my good friend, of the subcommittee, and also the full committee Ranking Member John Dingell for their help in scheduling these hearings and their cooperation in helping us to get witnesses.

After these hearings of today and tomorrow, it is my intent to sit down and try to sift through all the testimony and see what needs to be changed so that we can go to markup next week. I would ask members to prepare suggestions in legislative form for discussion and be prepared to offer them either to myself, to Mr. Boucher or have them drafted and ready to go to markup next week. I will be preparing a manager's amendment to incorporate whatever changes I think improve the bill.

I see lots of people here in the audience who we have worked with for the last few years. It is Christmastime, and so I am kind of in the spirit of which of you have been naughty and which of you have been nice. I don't think anybody has been really naughty; I can almost say I don't think anybody has really been nice either.

So I would say to you that normally Christmastime is—some celebrate Christmas Christmas Eve, some celebrate Christmas morning, some who are not of the Christian faith celebrate Hanukkah, but whenever and however you celebrate, I think it would be very nice for this subcommittee to give a Christmas present early to the country, to the full committee, if we could work together and pass a good electricity bill sometime next week.

So with that, I would yield the balance of my time and recognize my good friend, the distinguished ranking member, Mr. Boucher, for an opening statement.

[The prepared statement of Hon. Joe Barton follows:]

PREPARED STATEMENT OF HON. JOE BARTON, CHAIRMAN, SUBCOMMITTEE ON ENERGY AND AIR QUALITY

Today, the Subcommittee starts two days of legislative hearings on comprehensive electricity legislation, H.R.3406. This bill will most likely be the subject of a subcommittee markup next week, if the Congress is still in.

Today and tomorrow, I ask witnesses to be forthright and specific when talking about the bill. Keep in mind that this legislation is an attempt at a balance between stakeholders and Members, and few compromise bills are universally loved.

The Members of this Subcommittee, on both sides of the aisle, have spent a great deal of time reviewing electricity markets this year and in years previous. Major lessons we learn again and again are part of the bill before us today:

1. We must increasing the supply of electricity available to consumers;
2. We must improve the effective operation of our transmission grid; and
3. We must increase the capacity of our transmission grid.

First, we welcome a very distinguished panel of Federal witnesses. Deputy Secretary Frank Blake is back before us today, and I welcome you. Thank you for your past work with this Subcommittee on Price-Anderson and your previous testimony about electricity restructuring.

Next, we welcome back the four confirmed commissioners of the Federal Energy Regulatory Commission (FERC). I look forward to when you come back with a full slate of Commissioners. I commend the President's great decision when he announced the intent to nominate Joe Kelliher to FERC.

But back to the four of you. Led by my good friend, Chairman Wood, it appears you four have been quite busy lately. I expect you will be receiving many questions from Members today. I, for one, ask you to address recent actions and statements on Regional Transmission Organizations (RTOs), market-based rates in connection with RTOs, the market power screen test , the suitability of transcos in an RTO future, and whatever else we might be hearing about soon.

Chairman McCullough of the Tennessee Valley Authority (TVA) is also here today. Welcome, and thanks for your help in forging agreement, within the valley, among TVA, its distributors, as well as large and small customers.

Tomorrow, we will welcome the Securities and Exchange Commission on PUHCA and a regulator from the State of Arkansas. Following that, we will have our usual wide table of industry participants and observers.

I want to thank Chairman Tauzin of the full committee, Ranking Member Boucher of the subcommittee, and Ranking Member Dingell of the full committee for their help in scheduling these hearings and implementing a fair and open process. I thank all Subcommittee Members for the attention they have given to these issues.

After this hearing, it will be time to work on changes to the bill. I ask Members to prepare suggestions in legislative form for discussion and, if not accepted, for offering as an amendment during markup. I will be preparing a manager's substitute amendment incorporating some of the changes discussed today.

As I look out to the audience and to both sides up here, I see lots of people who have been nice. Not too many have been naughty, at least not all of the time. While I have no songs for you, I do hear from Santa that one of the packages under the

tree is a model kit for a pretty little electricity bill. My parents wouldn't let me open my presents early, but if we do our homework we just may get to open it next week. I can't imagine a more legislatively-satisfying holiday season.

Mr. BOUCHER. Well, thank you very much, Mr. Chairman. I appreciate the scheduling of 2 days of legislative hearings by the subcommittee prior to our taking further action on the chairman's electricity industry restructuring legislation.

Given the very significant changes that have recently occurred, both in the market for wholesale electricity and in the regulation of that market by the FERC, it is appropriate that we take stock of current circumstances before we take further legislative action. These hearings provide that opportunity, and I thank Chairman Barton for honoring the request that we made that these hearings take place.

I very much applaud the steps designed to strengthen the wholesale electricity market, which have recently been undertaken by the FERC. The Commission has issued notice of a proposed rulemaking to develop a uniform standard for interconnection. It has acted to ensure membership in broad Regional Transmission Organizations by companies that own the transmission lines. It has demonstrated, I think, a commendable determination to make the wholesale market more functional and more predictable.

To the extent that legislation is needed to reinforce FERC's authority in these areas, we should act. In my view, we should not take any steps which would impede the progress that FERC is seeking to achieve in perfecting the market for wholesale electricity transactions. And I am frankly concerned that some of the provisions in the measure now before us might have that effect, particularly the provisions in the bill that relate to Regional Transmission Organization membership.

I also question the appropriateness of repealing the FERC's merger review authority through which the Commission acts to promote competition and address market power concerns. The removal of merger review authority is all the more troubling when it is teamed with repeal of the Public Utility Holding Company Act, an event which inevitably will lead to greater industry consolidation and heighten concerns about the potential to misuse market power. Under these circumstances, the FERC's merger review authority may be more needed in the future than it is even at the present.

There is a clear need to encourage the construction of new transmission lines in many places around the Nation. The bill seeks to address this need through the creation of incentive pricing for new transmission lines and by conferring Federal authority to site new lines in instances in which the States deny approval for that construction. Both of these provisions are highly controversial. I will welcome the views of our witnesses, both today and tomorrow, on whether other approaches can achieve the goal of new transmission line construction.

In particular, I am interested in knowing whether Regional Transmission Organizations can encourage the needed investment under regular pricing without the use of incentive pricing. I am also interested in learning about instances in which those supporting Federal siting authority believe that States have acted ar-

bitrarily in balancing the need for new transmission against the other values that States have an obligation to consider. I am personally unaware of any such instances, and we did in fact inquire about such instances in previous hearings.

The chairman's measure focuses on a range of other complex matters, including the balance between State and Federal jurisdiction over transmission, transmission reliability, Federal authority over public power entities in certain circumstances and the repeal of PURPA. While I have reservations about many of the bill's provisions, I want to commend Chairman Barton for his single-minded persistence in working to achieve a landmark reform in our Nation's electricity laws and for placing before this subcommittee a comprehensive measure that addresses the most relevant topics.

I look forward to continued conversations with the chairman and with other members of the subcommittee as we continue to consider the best means of addressing the wholesale electricity market and its related concerns. Thank you, Mr. Chairman, and I want to welcome our witnesses, and I very much look forward to their testimony.

Mr. BARTON. The Chair would thank the gentleman from Virginia for that statement. It is the Chair's intention to continue opening statement. Mr. Shimkus has gone to vote and hopefully will be back so that we can continue without having any interruption. The Chair would ask if Mr. Bryant wishes an opening statement.

Mr. BRYANT. Yes. Thank you, Mr. Chairman; I have one. I would also like to thank you for holding today's hearing on H.R. 3406 and commend you for inviting such a distinguished panel of witnesses representing the Federal perspective on the electricity restructuring legislation. I especially look forward to my friend, Glenn McCullough, testifying, who is the chairman of the Tennessee Valley Authority, and I am sure Chairman McCullough would agree that among the residents living in the Valley there is an "if it ain't broke, don't fix it" mentality toward such legislation as restructuring our Nation's electricity market.

However, as America's largest public power company, TVA has—I should say America's largest public power company, TVA, has provided reliable, low-cost power to all of us in the Valley for nearly 70 years, and we are happy with the services TVA provides. However, there is a nationwide movement toward a more competitive electricity market. Several States have already deregulated their wholesale electricity markets, and times are changing. TVA must be prepared to change with them.

To prepare for life in a more competitive market, TVA, the region's 158-power distributor to its customers, and industrial users, after much negotiation, have reached a consensus on a TVA title. The title, this consensus title, would allow the distributors to renegotiate the contracts with TVA and to buy some power outside of the seven-state region or the so-called fence of TVA, which will help meet the growing demand from Valley consumers.

In addition, the title would permit TVA to sell excess power at a wholesale level outside the fence, which they cannot currently do. Additionally, TVA's 17,000 miles of transmission would come under the regulation of FERC for the first time. This would help FERC

in their effort to form Regional Transmission Organizations to facilitate the reliable flow of power.

I feel that H.R. 3406, the Electric Supply and Transmission Act, is the most appropriate vehicle for the TVA title, and I commend Chairman Barton for recognizing what is in the best interest of the Tennessee Valley and including the consensus agreement as the TVA title in H.R. 3406. I know there are some in the power industry who want to compete with the Valley on a one-way basis. These interests seek to create a market that favors their utilities and that will put TVA at a competitive disadvantage. I ask my colleagues on the subcommittee to recognize the efforts of the stakeholders throughout the Tennessee Valley and oppose them when the time comes up for this vote. It is very important to my constituents that the Valley's stakeholders be allowed to control the region's destiny in a restructured market.

Again, I thank the chairman for his work on the electricity restructuring issue, which I know is so important to him. And, furthermore, I want to thank him for his work on behalf of the residents and the numerous States involved in the Tennessee Valley. Thank you.

Mr. BARTON. Thank the gentleman from Tennessee and recognize the distinguished gentleman from California for an opening statement.

Mr. WAXMAN. Thank you, Mr. Chairman. The bill we are considering today is called Electric Supply and Transmission Act. I think a better name might be the One Last Gift for Enron Act. This follows the $254 million gift to Enron in the Republican stimulus bill and the long wish list of subsidies, tax breaks and deregulation provisions Enron received in the House energy bill. Enron's fingerprints are all over the legislation we are examining today. This bill essentially Federalizes the Nation's electricity transmission grid just as Enron had advocated for years.

Five and a half years ago, Enron CEO Ken Lay testified before this subcommittee and derided those who argued against Enron's vision of the future. He testified that we did not need to listen to those who argued that Enron's plan was untried and too risky or that we needed to go slow. He ridiculed the arguments that service will deteriorate or reliability will be put at risk. Mr. Lay testified that competition in the electricity markets would cause great things to happen. Consumers would benefit handsomely, the environment would be protected, and of course Enron would make a lot of money.

Mr. Lay's vision turned out to be dramatically wrong. California and the West have suffered from skyrocketing energy prices. A new report from the Consumer Federation of America, which I ask unanimous consent to introduce into the record, documents double-digit rate increases in Massachusetts, a 40 percent increase in New York and a 50 percent rate increase in Montana over the last year.

There has even been evidence of market abuses in Pennsylvania. And, of course, Enron itself is now in bankruptcy. Mr. Lay and other Enron executives essentially looted the company, while leaving employees and shareholders with nothing. Even the environment seems to be suffering. As a result of restructuring, emissions

of nitrogen oxides and carbon dioxide were significantly higher last year than FERC had projected just a few years ago.

The legislation we are considering should be put on display in a museum. It is an artifact of the era when corporate America swooned at the mention of Enron's name. I think we need to go back to the drawing board. The last thing we ought to do now is pass another law that makes it easier for top executives to steal and swindle millions of dollars from their workers and shareholders. First and foremost, we need to figure out how to prevent future energy collapses like Enron. The answer will require more regulation and oversight of energy marketers, not more deregulation like this legislation proposes.

We also need to be focused on how we ensure that electricity is reliable, clean and affordable. This will require doing more to promote conservation and renewable sources of energy. Even before the collapse of Enron many States were reconsidering restructuring. Of the 25 States that have decided to restructure, three electric utilities, nine are now reconsidering their decisions. Nevada even repealed its deregulation law of April 2001.

I am glad we are holding today's hearing, but clearly we need to hold many more before we consider moving legislation. As many people have remarked, September 11 changed our world. In its own way, December 2, the date Enron filed for bankruptcy, fundamentally changed how we need to think about energy policy. This should be a time for deep rest, deliberative reevaluations, not a headlong rush to legislation to preconceived ideological theories that fly in the face of the disastrous reality Enron-style deregulation is inflicting on millions of Americans. Thank you very much, Mr. Chairman.

Mr. SHIMKUS [presiding]. Thank you, Mr. Waxman. Just to inform the panelists, what I plan to do is conduct my opening statement, see if other members filter back from the votes. If no one gets here in time, then we will kind of recess in place until every member gets an opportunity, and then we will go to the opening statements. That is per direction of the chairman.

So I, too, want to thank the panelists here today, although I don't totally agree with my colleague from California. I have sat through more energy hearings than the years that I have been alive, seems like. And I have only been a member 5 years, so we have really—those of us who have been on this subcommittee for the past five or 6 years, I think we have got a pretty good handle on energy.

But be that as it may, I will start with a prepared statement and just say the Federal role in our Nation's electricity system is an important one. For years, it has worked to ensure that our Nation has reliable and affordable power, but the system that generated and delivered that power has changed dramatically, and the Federal Government's role has to change to meet the challenges of this new system.

Illinois is a very unique State. We have a deregulated market that will allow consumers to choose their energy supplier in the coming year. We lead the Nation in electricity produced by nuclear power. We are among the leaders in the amount of electricity generated from coal. Greenpeace released a study last month saying

that Illinois is the fourth in the Nation in the amount of planned power from solar electric systems, and Illinois will soon become a major player in electricity generated from wind power. On top of all that, there is a project in my district to create a hydroelectric dam.

Illinois has a truly diversified energy portfolio. The problem is how do we get all this low-cost power to consumers? And that is what I think we are here for to discuss. The answer is transmission. This legislation provides incentives and an environment to expand and update our Nation's transmission grid. It provides for a process for transmission siting that won't create a bottleneck at the States' borders, similar to what we saw with natural gas pipelines at the California border. We have utilities in Illinois that are begging to new transmission but are being forced to stop these lines once they hit the State borders. This bill will remedy that. And I say, constitutionally, in the interstate commerce clause, this is interstate commerce.

The bill also allows for open access to transmission for all transmitting utilities. If we are to have a truly national grid that is reliable and offers a seamless way to move power from one part of the country to another part, then it is important to have equal and open access to all transmission. The RTO provisions in this legislation mandate participation in an RTO but doesn't set a specific number of RTOs. I believe this is the correct approach. RTOs are needed to facilitate an open transmission system to move power easily from one place to another.

This legislation has a number of other provisions aside from what I have mentioned, but I wanted to focus on transmission, because it is most important to me. I look forward to addressing these and other issues in these hearings, and when we mark up this legislation hopefully before we leave before the Christmas break.

And with that, I will yield back my time, and I will now recognize the gentleman from Iowa, Dr. Ganske, for 5 minutes—for 3 minutes.

Mr. GANSKE. Thank you, Mr. New Chairman. I want to thank the Deputy Secretary, the FERC commissioners, the chairman of the Tennessee Valley Authority for joining us today, as well as the witnesses who will join us tomorrow, in particular, Mr. David Sokol of Mid-American Energy Company, which helps to supply energy in my Iowa district. I appreciate all of you for taking time to address the committee.

We have an obligation to help assure that our power generation system is ready to supply a reliable source of electricity, both for our own safety and for the productivity of our economy. The transmission system in our country is crucial in guaranteeing a consistent and uninterrupted flow of power to our cities, towns and rural communities. Recent events have magnified the concerns that we have about our power supply, but even before those events there were many steps which needed to be taken to improve our power grid and our transmission capabilities. Our electricity power grid is an essential part of the American economy and of our basic infrastructure.

I strongly believe we need to promote the use of renewable resources. My State of Iowa has been a leader in the development of wind energy power. I believe it is a clean, practical source of energy which can be utilized to a much greater extent than it currently is. Iowa is tenth in the country in the potential for utilization of wind resources, but we are currently third in the amount of wind energy produced. Wind turbines in Iowa already produce enough energy to power more than 60,000 residential homes. I know that in more temperate areas of the country solar power holds more potential.

The provisions of this legislation which would encourage the use of net metering systems around the country are a positive step toward making the use of solar and wind generated power a more practical alternative to the small producer. Net metering can play an important role in facilitating the development of wind and solar power by small producers. I commend the chairman for his leadership in including this section in the legislation, and I plan to work with him in offering an amendment during the markup, which I hope will serve to clarify a couple of the provisions.

I thank the chairman, and I yield back my time.

Mr. SHIMKUS. The gentleman yields back his time. Chair recognizes the other doctor, from the great State of Georgia, Dr. Norwood.

Mr. NORWOOD. Thank you very much, Mr. Chairman. I would like to simply place my opening statement in the record, and perhaps you would reserve the amount of time I would have used for an opening statement and extend the amount of time I will have for questions.

So if you will do that, I will yield back to you.

Mr. SHIMKUS. I would say that is above my pay grade, so you will have to negotiate.

With that, seeing no other members present, we are going to ask the panelists and our guests to recess in place until we come back.

[Brief recess.]

Mr. BARTON. The subcommittee will come to order. Congressman Hall will stop meeting and greeting. Was Congressman Shimkus the last one to give an opening statement, do we know? Ganske? So the last one was a Republican? Okay. The Chair would recognize Mr. Sawyer for an opening statement.

Mr. SAWYER. Thank you very much——

Mr. BARTON. The Chair is in error, and Mr. Markey was in attendance before Mr. Sawyer. The Chair would recognize Mr. Markey for a non-musical opening statement.

Mr. MARKEY. The theme is movies today, okay? You know, at the very end, Mr. Chairman, of the 1942 Hollywood classic, Casablanca, Captain Renault, the French police inspector, played by Claude Raines, has just pulled up to the crumpled body of the Nazi officer that Humphrey Bogart's character just killed. He jumps out of his car and says, "Major Strasser has been shot." Bogart looks at him with expressionless eyes, and Renault turns to his gendarmes and says, "Round up the usual suspects." That is kind of what we are doing here today, Mr. Chairman.

In May, the majority pulled the plug on its markup of California's emergency electricity legislation. In July and August, the ma-

jority short-circuited efforts in the committee and on the floor to address the electricity problems taking place in the West as part of the comprehensive energy package. And so today we are rounding up the usual suspects to interrogate them yet again in a process which at this point appears increasingly unlikely to result in enactment of any public law.

Meanwhile, in a hearing room right across the hall from here, in the Banking Committee, another feature is headlining. It involves the dramatic implosion of a company called Enron. Last year, the company was No. 7 on the Fortune 500; today, Enron is essentially a penny stock company reduced to bankruptcy. What happened? Where did all the money go? This little drama is a tale of greed and ambition with multiple plot twists, elaborate deceptions, villains and victims. It includes complex deals with mysterious insider partnerships dubbed JEDI, Chewbacca and Raptor. What a hearing, huh?

These are accounting—there are accounting firms with apparent amnesia about their public responsibilities and scores of Enron employees who have just seen their retirement savings evaporate as they stood helplessly by unable to shift funds into other investments.

So I would ask, is this subcommittee going to hold any hearings on the Enron debacle before it proceeds to mark up an electricity bill? It seems to me there are many lessons that this subcommittee could learn from what went wrong with Enron. Are we going to thoroughly investigate what happened to Enron and what it means to emerging electricity markets? Or are we going to engage in the absurd pretense that the collapse of what was once the Nation's largest electricity and natural gas marketing company has nothing to do with our electricity markets? Does anybody think that if Enron had been the subject of greater regulatory oversight, such as the types of rules that we require for traders in securities, traders in futures or other financial intermediaries, that the types of financial shenanigans that occurred and took place would have been allowed to occur? I think not.

In the aftermath of the Enron collapse, I think that we need to look very seriously at extending some greater oversight over the trading of electricity. Right now the bill we have before us does not address this issue. Mr. Chairman, I ask unanimous consent to address the committee for 1 additional minute?

Mr. NORWOOD [presiding]. Any objection? Mr. Markey, the chairman objects. We need to get through this so everybody will have a turn. We have a lot of witnesses we want to hear from.

Mr. MARKEY. I know, I know, a lot of witnesses. I appreciate it, I appreciate it.

Mr. NORWOOD. Mr. Sawyer, you are recognized for 3 minutes.

Mr. MARKEY. Excuse me. Oh, did anyone object?

Mr. NORWOOD. I did.

Mr. MARKEY. You objected, Mr. Chairman.

Mr. NORWOOD. Yes.

Mr. MARKEY. Why is that?

Mr. NORWOOD. Because we have a lot of witnesses we need to hear from, and all of us are going to read the record to finish listening to your statement.

Mr. MARKEY. No, but Mr. Chairman, let me ask—point of personal privilege, Mr. Chairman. I did not schedule this hearing for 1 in the afternoon. You can't persecute the persecuted, okay? You are basically now holding the minority accountable for the scheduling tactics of the majority. Now that is not fair to us to wait for weeks to have a hearing like this and then to tell us that we can't be extended 1 additional minute. That doesn't show any good grace or courtesy on your part.

Mr. NORWOOD. It doesn't show any good grace to extend over the time that we have all agreed to either. Mr. Sawyer, you are recognized for 5 minutes.

Mr. MARKEY. You are noted for your good grace, Mr. Chairman. I mean it is a personal trait that you hold dear, I thought, and here it is that you are making an exception only because, I would hate to say it, but it seems to be personal, and the subjects which I am raising seem to bring personal pain to you. And it is not that I mean to have you pointed out as the person not having the hearing on Enron, it is only that I just wanted to finish what I thought was a relatively humorous and——

Mr. NORWOOD. Mr. Markey, you now have your other 1 minute. Mr. Walden, you are now recognized for 3 minutes.

Mr. MARKEY. Mr. Chairman, you have moved from the jocular to the jugular here, unnecessarily, okay? I was keeping it in a relatively light vain rather than——

Mr. NORWOOD. Mr. Walden, you are recognized for 3 minutes.

Mr. WALDEN. Thank you, Mr. Chairman. I would like to hear from the witnesses, so in essence of time, so we can get on to the subject at hand, I will waive the opportunity for an opening statement and would appreciate time during questioning. Thank you, Mr. Chairman.

Mr. NORWOOD. Mr. Sawyer, you are now recognized for 3 minutes.

Mr. SAWYER. Thank you, Mr. Chairman. The struggle that we are all going through in trying to establish functional, stable electricity markets is an important one. We can't just sit back and hope that markets will emerge of their own accord. They simply won't function without an appropriate regulatory framework to support them, and these hearings are an important step toward establishing them.

We are in the middle of an historic transformation of vertically integrated utilities to a system of nationwide wholesale competition and retail competition in about half the States, merchant generators and soon RTOs. This is based on the straightforward idea that modernizing regulation to move power from low-cost producers to end consumers in a competitive market can result in cheaper and more reliable electricity. But if we are going to fulfill that promise, it seems to me we need to take steps now to update a transmission system that has not kept pace with the changes in the way electricity is generated and regulated.

Wholesale competition has dramatically increased the number of transactions and the amount of electricity being sent along a makeshift grid that was designed decades ago to handle a smaller number of point-to-point transactions. At the same time, investment in new transmission has declined by an average of about $117 million

a year, each and every year since 1980, and the decline is actually longer than that. It is, in short, a system in long, slow atrophy. The result has been predictable. Congestion, rising electricity prices, the lurking risk of blackouts as transmission gets caught in bottlenecks.

This is a recognition that in order to create functioning, competitive markets, we need to address several issues. First, we need to redress the decline in investment in transmission. Transmission is no longer the low-cost, country cousin enterprise that it used to be. We need to bring rates of return in line with higher risk involved in providing transmission—provided that transmission assets are controlled independently to assure open access to generators.

Incentive and performance-based rates, a concern to some, do not have to be a giveaway to the electric industry; rather they are a smart investment, properly managed, to create viable, independent transmission business and to make up for the shortage in capacity in this country. Innovative rates have the potential to end up lowering electricity costs by getting rid of the price distortions caused by transmission bottlenecks. That is not simply theory; we have experience of that in the not too distant past.

Second, we have got to encourage demand management programs through the use of new technologies to expand the capacity of existing rights-of-way. I also believe there needs to be some form of backstop Federal authority in siting. Providing for new lines is an important part of relieving identifiable bottlenecks, and giving the States time to do that, after which the FERC would have the authority to approve projects if the States have not been able to do so, I think is an important component.

Fourth, and finally, I believe we need to establish a single mandatory national reliability organization to create and enforce technical reliability standards that do not endanger the stability of the grid. Moreover, I would hope that they would be empowered to create procedures to safeguard the grid itself against terrorist attacks.

I look forward to hearing from our witnesses. Thank you for your flexibility in time and yield back whatever may remain.

Mr. NORWOOD. Thank you very much. And now I would like to recognize our distinguished chairman of the full Commerce Committee, Mr. Tauzin.

Chairman TAUZIN. Thank you, Mr. Chairman. I want to thank Chairman Barton for calling this hearing and for moving on this process. This has been a labor of love for the chairman of this subcommittee, and I want to encourage you all in this endeavor. Mr. Barton has worked for a long and hard time crafting an Electric Supply and Transmission Act, which we are going to hear comments and suggestions and analysis on today. And I want to thank him for that effort.

This is an attempt, literally, to comprehensively deal with the questions of supply and transmission. Regardless of how you feel about energy markets and whether they work or don't work or whether deregulation crafted properly can work well and crafted improperly, as we saw in California, can be an absolute failure, we know two things: That if there isn't an adequate supply and if that supply cannot be moved properly, that not only will the markets fail but any attempts to properly deregulate are not going to suc-

ceed. And so Mr. Barton has set upon a course that hopefully will take this subcommittee forward in producing for our committee and for the Congress a piece of legislation designed to ensure those two elements are as abundantly available to Americans as possible.

You know, until recently, electricity was sort of taken for granted. I saw a poll in California where people were asked where electricity came from, and awfully high percentage said, "From the wall." I also saw a poll that said when people were asked about the gasoline spikes in this country, they said, "Isn't it remarkable that the gas companies knew just where to put those stations right on top of the gas supplies?"

There is a lot of misunderstanding about electric markets and energy markets in this country, and we all assumed that when you turned the switch on electricity was going to be there. We never had to worry about it. Absolutely reliable. And then we saw the shortages in California and the West, and we saw what tremendous economic havoc it can cause to a region of the country that is so important to our Nation. We just can't have that happen again, and we can't have it happen in other parts of the country.

In a few weeks, we begin the year 2002. It will have been 10 years, a whole decade, since Congress enacted major energy legislation, which was the Energy Policy Act of 1992. In that time we have seen competitive electric markets struggle to take hold. We have also seen more clearly the vital connection between our Nation's economy and a clean, affordable, reliable electric supply. And we have come to recognize what is necessary to update the electric system for future economic growth.

We learned, for example, that the four main structures of the Internet system in this country, when looked at in toto, consume as much energy as the entire country of Italy consumes—about 8 percent of our national total. For that economy to grow, we had better have reliable sources of electricity and reliable means to deliver them to the parts of the country that require them.

So it is time for Congress to address the issue again. It is just that simple. And when we passed comprehensive national energy policy legislation earlier this year, we made it very clear we would be moving electricity at a later date. The later date is here.

As a Nation, we can't rely upon the FERC alone to do this for us. Well, the simple truth is that on occasion FERC may think they can solve all these problems, but there is only so much they can do. We in Congress must give them guidance, and we must give them the tools that they need to make sure that American ratepayers are protected and assured of affordable electric supplies for the next 10-year period and beyond.

FERC can help us determine what to do, and that is why I am very interested in what our FERC commissioners will say about this bill today and why I am very pleased that you are here and ready to help us think through the policy that will help you and us work through the right answers.

I want to welcome Chairman Wood, and we have had a private meeting before, and I want to thank you for agreeing to serve the country in a hot spot. This is a tough one. And for all of you on the Commission. We all know these are going to be tough decisions as we move from regulated markets and shortage markets to more

abundant and flexible markets in the electricity marketplace of America.

I want to also welcome Deputy Energy Secretary Frank Blake again before our committee. We always appreciate your work with us, Frank, and——

Mr. MARKEY. Mr. Chairman? Mr. Chairman? I would like to make a unanimous consent request, Mr. Chairman, that the gentleman from Louisiana be allowed to consume as much time as he desires in his opening statement.

Chairman TAUZIN. Actually, if my time is up, I am going to wrap in one word, and that is I also want to welcome the TVA chairman Mr. McCullough, to the subcommittee and look forward to hearing all your testimony. I yield back any time that I may have improperly consumed.

Mr. NORWOOD. It has been an observation, generally, that the chairman of the full committee does get about whatever time they wish to consumer. Mr. Gordon, you are recognized for 3 minutes.

Mr. GORDON. Thank you, Mr. Chairman. I think we have already had one interruption today with a vote. I am going to put my comments in the record so that we can move forward with these witnesses. I don't want them to caught again.

Mr. NORWOOD. Thank you, Mr. Gordon. Mr. Whitfield, you are recognized for 3 minutes.

Mr. WHITFIELD. Mr. Chairman, I know you will be disappointed, but I am going to waive my opening statement.

Mr. NORWOOD. Actually, I am disappointed, Ed, but I accept that. Mr. Hall, you are recognized for 3 minutes.

Mr. HALL. Mr. Chairman, I guess I am pleased that we are conducting these hearings. I have mixed emotions about it. I think the one good thing that can come out of it is to get some detailed comments on the language of this legislation from the folks that are in front of us here. All of us know a lot has happened in the 2 years or so since we marked up 2944 in this subcommittee. For some, like California, it has been agonizing. I remember earlier in the year how we dreaded to see August hit. August was lurking out there, and luckily we had a fairly mild August. We are learning in Texas, and it is not easy. And at the Federal level, we have begun to zero in on dealing with the essential Federal issues.

For the most part, I think they are reflected in this legislation, and while I don't think for a minute this is a perfect bill, I think it is a good enough bill to move to the full committee. I know the concerns of the coops, of public power folks, of State commissions and a lot of others, and hopefully we can work out ways to find ways to deal with their concerns in this legislation.

One, I hope that we can get some stability and certainty to the electric power industry and customers. I think I have used about a minute and a half. Would I get in trouble with the chairman if I wanted to offer to my friend from Boston my last minute and a half?

Mr. NORWOOD. Well, after what you said about him in the last hearing on nuclear energy, I think you ought to, and it is certainly agreeable with——

Mr. HALL. Well, all right. I really want to do that.

Mr. NORWOOD. Go ahead.

Mr. MARKEY. You know, I just want to—I would like to say that if you looked up the word "graciousness" in the dictionary, Ralph Hall's picture would be next to it. You know what I mean? This man is just the embodiment of the wonderful spirit of collegiality that has always characterized this committee. And I just want to say how honored I am to serve with you and despite the fact that you come from Texas, there is a great deal of admiration. If we don't produce anything up in Massachusetts, we produce a lot of admiration for the gentleman from Texas, and I——

Mr. HALL. Can I ask you something?

Mr. MARKEY. I will be glad to yield to the gentleman.

Mr. HALL. Are you about to do me like those two boys did the Sierra Club? They had their meeting, and they had Santa Clause there and a little boy on each knee, and one of them said, told Santa, he said he wanted for Christmas a bird feeder, and all those Sierra Club people clapped. They love people that love little birds. And the other one said, "And a couple of BB guns."

You are not going to do me like that, are you?

Mr. MARKEY. Where am I going now? You know, somebody has to be Ed McMahon. Anyway, it is just great to have you all here today.

I see vast amounts of billable hours out here, and we can't believe what they are saying. They are really talking about marking up right before we break for Christmas. And it is like a Godsend, there is like hundreds of memos being faxed to energy companies all over America putting them on alert that this committee may be thinking about marking up——

Mr. NORWOOD. Mr. Hall, do you wish to reclaim your time now that the time is up?

Mr. MARKEY. I think we should have the SEC investigate all these people sitting out here collecting for what they are doing today. Anyway, thank you, Mr. Chairman.

Mr. NORWOOD. The Chair would like to now recognize Mr. Largent for 3 minutes.

Mr. LARGENT. Thirty minutes?

Mr. NORWOOD. Three.

Mr. LARGENT. Oh, 3 minutes. Thank you, Mr. Chairman. I do want to commend Mr. Barton for holding the hearing today on tomorrow's—and tomorrow's legislative hearings on the recently introduced bill, H.R. 3406, the Electric Supply and Transmission Act of 2001.

As many in this room know, one of my greatest concerns when it comes to restructuring is how do we ensure an open and transparent wholesale transmission market? There are transmission constraints throughout the system. Probably one of the most notable is the Path 15 that runs the length of California. The constraints are only magnified by the various forms of regulation of the grid. I think the word picture that comes to mind when thinking about the grid's current regulatory structure is swiss cheese.

I know that FERC commissioners here before us today share similar concerns, as evidenced by their recent rulemakings and orders. And with that, Mr. Chairman, I want to yield back my time and insert my entire statement for the record; look forward to this hearing.

Mr. NORWOOD. So ordered. Thank you, sir.

Mr. NORWOOD. Ms. McCarthy, you are recognized for 3 minutes.

Ms. MCCARTHY. Mr. Chairman, I am going to put the bulk of my remarks in the record, if you wouldn't mind, and I thank you and Ranking Member Boucher for holding this hearing. And I am very much appreciative of the panel's efforts to educate us on the need to protect our national security and take a look at diversity and conservation and reliability and certainty in our electric energy delivery system. I hope this committee will take a look at distributed generation of renewable energy sources that can also be a viable way to supplement our grid and diversify the Nation's energy supply, because I do think diversity is the key to the future as we address electric energy needs and also global climate change.

I would like to yield back the balance of my time, Mr. Chairman, and just put the extent of my remarks into the record.

Mr. NORWOOD. So ordered. Thank you, Ms. McCarthy.

We will postpone just for a second till the chairman gets here. He wants to do the introductions of the panel. I expect him here any second.

Mr. MARKEY. Mr. Chairman, could I be recognized while we are waiting? I have like 1 more minute to go.

Mr. BARTON. Has Mr. Dingell been given an opportunity to have an opening statement?

Mr. DINGELL. Mr. Chairman, I thank you. Mr. Chairman, I understand that, first of all, my own concerns about the Enron situation and the wisdom of proceeding with the markup before we've thoroughly examined the debacle that occurred in that matter have already been raised by Mr. Markey and Mr. Waxman. I think it is regrettable that Mr. Markey was not given an additional minute to conclude his opening statement, because I think it would have been of value to us in our consideration of this matter.

I would be happy to yield Mr. Markey a minute of my time, because I share his concerns about Enron and the future of the electricity markets. I have a fine statement that I will be happy to submit for the record in order to enable the committee to accommodate Mr. Markey and to perhaps get into the question of some of the rascality and misfortunes that have been inflicted on so many people by the Enron debacle. While we are talking about whether or not PUHCA and other Federal regulatory statutes should be repealed, modified and so forth, given the misfortunes and failures and, quite frankly, the obvious abuses and perhaps even criminal misbehavior of the Enron matter.

So I ask unanimous consent for two things, Mr. Chairman: One, that I be permitted to revise and extend my statement and include it in the record, and, two, that the balance of my time be yielded to Mr. Markey.

Mr. BARTON. Will the gentleman yield?

Mr. DINGELL. I am happy to yield.

Mr. BARTON. We have the tradition on this subcommittee of letting the ranking member of the subcommittee and the full committee speak, I won't say forever, but I try not to cut our senior membership off. So the gentleman from Michigan, as the ranking member of the full committee, really has such time as he may consume. And if he wishes to yield that to the distinguished member

from Massachusetts, that is fine with me. I don't want us to get into a tizzy here before we even hear from our distinguished panel. So I am open.

Mr. DINGELL. Mr. Chairman? Mr. Chairman, I knew that your natural grace and dignity and charm and ability and the very fine conciliatory character that you have always displayed in your capacity would encourage you in that direction, and I want to express to you my thanks.

Mr. BARTON. So do you wish to yield to the gentleman from Massachusetts?

Mr. DINGELL. At this time, I would ask unanimous consent I be permitted——

Mr. BARTON. You don't even have to ask unanimous consent; you just yield to him, and we will put him on his good graces to be his naturally charming self in an expeditious fashion.

Mr. MARKEY. Thank you, Mr. Chairman.

Mr. DINGELL. As always, Mr. Chairman, you are gracious, thank you.

Mr. MARKEY. You are gracious, Mr. Chairman. I thank you. And I think Mr. Hall is kind of the master of the metaphor of the parable within which the truth emerges, and I think his story about the rabbits and the BB gun kind of have a certain truth.

And I was thinking what would be the analogous metaphor which I would use, and it came to me, and it's this: It's the story of the mother with her two children, and they were at the zoo, and the children went into one of the cages and they saw a lion laying with a lamb, and they were remarking on how beautiful it was. And the mother was exclaiming that it was the biblical fulfillment of the prophecy of the lion and the lamb laying together peacefully. And along came the zookeeper, and the mother was just saying how beautiful it was to see the lion and the lamb lying together. And the zookeeper said, "Hey, lady, don't get excited. We've got to put a new lamb in every day."

And so this legislation that we debate—and Mr. Dingell and I and I think most on our side share this view—in my opinion is heading toward the point where we will just be feeding more lambs into a system which, unfortunately, is broke and that we are not going to be providing the powers to the FERC which they are going to need in order to protect the lambs, the upstarts, the consumer, the competitors, those that want to have a full place within this energy electricity structure, and we hope that this hearing will help to illuminate those deficiencies. I yield back the balance of my time.

Mr. BARTON. Does Mr. Dingell wish to continue his opening statement?

Mr. DINGELL. You're so gracious that I will simply rely on my authority to insert this in the record.

Mr. BARTON. Without objection.

Are there any other members who have not yet had an opportunity to present an opening statement? Hearing none, the Chair would ask unanimous consent that all members not present have the requisite number of days to put their opening statement in the record.

[Additional statements submitted for the record follows:]

PREPARED STATEMENT OF HON. HEATHER WILSON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW MEXICO

Mr. Chairman, thank you for holding these final hearings on electricity and the electric power industry and for bringing together these excellent witnesses on electricity issues.

The issue of electric transmission policy is very important and it is an integral part of our energy policy. The transmission grid is an integral part of our energy infrastructure and we need a strong, reliable, flexible energy grid to move our electricity. The events in California this past year are evidence that we need to make positive changes to ensure that there is an adequate supply, sufficient transmission, improved reliability, reasonable cost of our nations electricity.

I applaud the Chairman of this Committee for setting out the draft of this bill months ago and asking for input. There are provisions in this bill that I like and some that I have some concerns about, particularly issues impacting states rights and the rural electric cooperatives. It appears to me that there are a number of provisions in this bill that FERC has authority to act on—they do not need additional authority. (Examples. RTO's and incentive rates.)

Electricity markets are regional in character. They are defined by the three electrically-separate interconnections. The Western Interconnection includes all or parts of 14 western states and western Canada and northwest Mexico. *Regional markets require regional solutions.*

States have and will continue to be major players in this nation's electricity policy. *I seek cooperative approaches that will encourage coordinated state and federal action, not federal preemption of states.*

One of our challenges is to *enable states and FERC to collaborate on regional electricity issues.* FERC has recognized this need in their November 9 order. We need to amend HR 3406 to build on FERC's initiative.

The some of the issues that need to be addressed are:

- We need to *amend the reliability provisions* to provide states, when acting on a regional basis, significant say in the design and enforcement of reliability standards.
- We need to *delete Section 402 that gives FERC the power to preempt states on the siting and permitting of transmission facilities.* FERC does not have the expertise, resources or local knowledge to make transmission siting and eminent domain decisions. This provision is not needed in the West. No western state has ever denied a permit for an interstate transmission line. The major challenge to permitting new transmission in the West is getting rights-of-way across federal lands.
- We need *to rethink the preemptive powers HR 3406* would grant FERC and the Federal Trade Commission in the areas of interconnection standards, net metering, demand response and consumer protection.
- In the case of interconnection standards, FERC may already have sufficient authority.
- In the case of demand response, many programs were put in place during the Western electricity crisis. We are now getting valuable information from those measures and states will be able to incorporate such information into their own measures. Even within the West, there are important differences among the states that need to be recognized. In the Northwest, which is reliant on hydroelectric generation, reducing total energy use is typically more important that cutting peak load. Uniform FERC standards would not recognize such differences.
- In the case of consumer protection, states, particularly those that have moved to retail competition, largely have in place consumer protection provisions.
- We need to ensure that FERC oversight over the rural electric co-operatives and public power is reasonable. Except for a few isolated examples, locally owned utilities typically do not have surplus electricity to sell. These systems do not represent a significant presence in wholesale markets, and they have been and will continue to be net purchasers of generation.
- Section 201 creates FERC-lite for co-op that transmit electricity. The co-op would set the transmission rate and the FERC would review it to ensure it satisfies the "comparability" standard. The co-op retain control of rate setting and FERC expands it jurisdiction over co-op transmission rates.
- However, Section 702 would negate any notion of FERC-lite authority and should be removed. It transfers the rate setting function from the co-op to FERC which destroy Section 201.

I realize that HR 3406 includes provisions for retaining some state-specific requirements in these areas. However, I am concerned whenever we empower a fed-

eral agency to make determinations of whether a state program is "equivalent to" or "not inconsistent with" we are opening the door to new intrusions by the federal government into state authorities. While the current members of the FERC or FTC may not exercise such authorities to second-guess states, there is no assurance that future members of those bodies.

I am looking forward to hearing from the witnesses as we continue to work on the state and co-op issues.

Thanks

PREPARED STATEMENT OF HON. GEORGE RADANOVICH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. Chairman, today's hearing is a very important step towards securing America's energy future. As this year comes to a close, we are now well into the Twenty-First century. It is time for us to discard entrenched views and work to secure ample, reliable and affordable energy for our future.

We are now decades from the 1930's and the 1970's. It is time for a change from the paradigms of industry currying favors from political regulators, or of a cottage industry of subsistence energy. Fair markets, consumer choice, and responsible entrepreneurship are the path to a vibrant future.

The California Electricity Crisis of the past year is only temporarily dormant. The underlying problems remain unresolved. Already we see signs of a return to power plant construction delays, regulatory manipulation, and consumer disregard. We are kidding ourselves if we believe that a return to monopolies, or to the utopian proposals of the 1970's and 80's will provide reliable and affordable power for an industrious state of 54 million citizens.

There are many positive steps in H.R. 3406 I would like to endorse. First, electricity markets must be designed to work both in times of overabundance and of undersupply. Consumers in California have shown their unwillingness to pay any price for electricity as demonstrated by their conservation efforts. Title I, Section 103 is a necessary action to let the demand side, and consumers, be an active part of the market.

Second, we learned in California, that PURPA has unintended and disastrous consequences on the prices consumers pay for electricity now and for years to come. PURPA QF contracts represent approximately one-third of California's outstanding electricity debt. PURPA was written for a structure of monopoly electricity providers and in its present form is no longer workable.

Third, PUHCA did nothing to help consumers in California's Electricity Crisis. Any benefits of this arcane law are not evident to consumers, although compliance with the law does impose additional consumer costs. Since any benefits to consumers from this law no longer exist, let us repeal this law and thus its costs.

There are some aspects of this law, which I would like to see strengthened. I am concerned that Title I, Section 102 does not mention hydroelectricity and geothermal sources along with solar, wind and biomass. Small hydroelectric and geothermal sources are important renewables that are available in the Sierra Nevada Mountains. The Department of Energy has estimated that there are 3,000 MW of incremental hydroelectricity, that can be responsibly developed in California alone. We must do everything we can to secure the future of this vital resource for our nation.

I am also concerned that the net-metering section carries risks similar to those we are trying to correct through the repeal of PURPA in that it shifts the costs of "storing" energy to the load serving entities. These types of transactions should be limited to the capacity of a utility to store energy, such as by a pumped hydro project. No benefit is gained by requiring utilities to build power plants to sit idle waiting for cloudy or windless days.

Lastly, I believe that the comparison of our transmission system to our national road system prior to the development of the Interstate Highway System is an appropriate one. The Federal Energy Regulatory Commission is clearly struggling with how to put these various local systems into a unified national framework. This legislation attempts to be of help to that process by addressing issues such as RTOs, incentive rates, and eminent domain, but it fails to provide a context for those measures.

It is time to take a chalk to a clean slate. We can be of tremendous help to this process by providing a "bright line" criteria to focus the FERC on interstate transmission, and the States on intrastate distribution. A separation criteria of 100 KV is reasonable and appropriate. We should also require that the Department of Energy provide a layout, by a date certain and with state input, for a 21st Century National Interstate Transmission Highway of 100 KV lines and above which incor-

porates all existing transmission lines in this size range. Only transmission constructed in accordance with such a national plan should be the beneficiary of incentive rates and eminent domain.

I encourage all of the parties with interests in this legislation to abandon entrenched positions and to consider this legislation in the light of the national interest and to best help consumers have secure and affordable energy for their futures.

PREPARED STATEMENT OF HON. CHIP PICKERING, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MISSISSIPPI

Mr. Chairman, I would like to take this opportunity to bring to your attention as well as that of the Commissioners concerns I have regarding the new interim, generation market power test the Commission adopted late last month. As I understand it, the Commission abandoned the so-called "Hub-and-Spoke" generation market power screen, which had been in place for many years and relied upon by market participants, and adopted a new, definitive generation market power standard called the "Supply Margin Assessment" test.

I have some real concerns about FERC's action. First, I find it deeply troubling that such an important change in policy would be ordered by FERC without any process for public comment.

Second, the substance of the policy change itself seems ill-advised and wrong. I don't pretend to understand all the details or the differences between the "Hub-and-Spoke" and "Supply Margin Assessment" methods. And as you know, this Subcommittee has spent a lot of time the past few years trying to understand, address, and respond to legitimate market power concerns. We all want to avoid another California-style mess. We all share the goal of having competitive wholesale power markets. Addressing legitimate market power concerns is an important part of this process. But I must tell you all that there appear to be very serious problems with the new interim, generation market power test you have adopted.

For example, we have heard that the new test will discourage new generation investment and potentially expose other regions of the country to "California-like" dependence on short-term markets and power purchases. Additionally, we have heard that the new, interim test may effectively deny most, if not all, of the nation's investor-owned utilities that still own generation plants market-based rates in their home states. This not only appears unfair, but also may create a perverse incentive against longer term investments as utilities and major merchant plant developers try to avoid being or becoming a pivotal supplier and flunking the new test in certain areas. This, combined with the blanket refund obligations you all have proposed, may actually end up increasing consumer rates, create tremendous regulatory and financial uncertainty, and lead to an unhealthy reliance on shorter term and riskier transactions. I thought we had been down this road before and were hoping to take a better-planned route to competitive wholesale markets.

We all want to avoid another California debacle. But in view of all the legitimate problems that have been raised about this interim, market power test, and since you have already announced that you will be starting a notice and comment rulemaking proceeding to address and adopt a longer-term generation market power method—which I encourage—I would ask that the Commission not implement or enforce in any way this new interim method until all of its potential effects are better understood. This can only be done after the Commission receives more input from all interested parties—including state Commissioners—in a notice and comment rulemaking proceeding. In my view, reviewing the rehearing petitions, while important, does not substitute for a full-blown rulemaking proceeding.

While I understand the Commission delayed full implementation of the new test on December 20, 2001, I am still concerned about the thought process leading up to the original order. Why did the Commission risk disrupting what appear to be efficiently operating wholesale electricity markets in most parts of the country to implement a potentially costly and problematic interim test—especially as we head into the winter heating season? It doesn't appear that the Commission even considered that in many parts of the country, electricity prices have been decreasing—in some areas significantly—as new merchant plants come on line. Simply put, I don't see a crisis warranting such a dramatic intervention in the market that would justify such a major departure from long-standing FERC policy.

We all share Chairman Wood's and Commissioner Brownell's view that the "long-term success of the market model to address customers' needs depends upon sufficient infrastructure and balanced market rules." However, the new, interim generation market power test appears to be inconsistent with these important goals. If you all want utilities to join Regional Transmission Organizations—a goal I share—this

approach seems like an awfully indirect, punitive, and potentially dangerous way to get there. I would ask you all to take a step back and fully consider the impact of the new test and hear from all concerned before it has unintended and bad consequences for consumers and our nation's electricity markets. I would hope you would consider these concerns in a notice and comment rulemaking proceeding and not just review the pending rehearing requests.

Mr. BARTON. The Chair now wishes to welcome its distinguished first panel. We have the distinguished Deputy Secretary of Energy, Mr. Blake, from the Department of Energy; we have the four FERC commissioners, including their distinguished Chairman, Mr. Wood, and we have the chairman of the Tennessee Valley Authority, Mr. McCullough.

Ladies and gentlemen, your statements are in the record in their entirety. We are going to start with Deputy Secretary Blake. Then we will go to Chairman Wood, and I would assume each of the other commissioners have a statement you wish to make; is that correct? Okay. And then we will go to Mr. McCullough.

Welcome, Mr. Blake.

STATEMENTS OF HON. FRANCIS BLAKE, DEPUTY SECRETARY, U.S. DEPARTMENT OF ENERGY; HON. PAT WOOD III, CHAIRMAN, FEDERAL ENERGY REGULATORY COMMISSION; HON. LINDA K. BREATHITT, COMMISSIONER, FEDERAL ENERGY REGULATORY COMMISSION; HON. NORA MEAD BROWNELL, COMMISSIONER, FEDERAL ENERGY REGULATORY COMMISSION; HON. WILLIAM L. MASSEY, COMMISSIONER, FEDERAL ENERGY REGULATORY COMMISSION; AND GLENN L. MCCULLOUGH, JR., CHAIRMAN, TENNESSEE VALLEY AUTHORITY

Mr. BLAKE. Thank you, Mr. Chairman and members of the committee, and thank you for the opportunity to come before you today. I will just briefly summarize my testimony.

The administration strongly believes that we need to continue the work of establishing open, transparent and competitive electricity wholesale markets. This will benefit consumers, through increased supply and lower prices, and it will benefit the reliability and security of our transmission infrastructure, an infrastructure that is essential to our economy.

The President's national energy policy calls for comprehensive electricity legislation. It respects the role of the States and focuses on the regulation of wholesale power markets and transmission in interstation commerce. We welcome this committee's attention to the issues and applaud the chairman's leadership on this matter.

As outlined in my testimony, we agree with most of the goals of the proposed legislation, and we look forward to working with the committee on those areas in the specifics where we might have some disagreement.

let me close by emphasizing what we view as the importance of following through on our nation commitment to open and transparent markets. We need to continue on a clear path forward to assure that affordable capital is available for the infrastructure needs of our country. Thank you very much.

[The prepared statement of Hon. Francis Blake follows:]

PREPARED STATEMENT OF HON. FRANCIS BLAKE, DEPUTY SECRETARY, UNITED STATES DEPARTMENT OF ENERGY

Mr. Chairman and Members of the Subcommittee, I welcome the opportunity to testify before you today on Chairman Barton's bill, HR 3406, the Electric Supply and Transmission Act.

The Administration believes that electricity legislation—done right—will make wholesale power markets more competitive, strengthen the transmission grid, increase electricity supply, lower prices, protect consumers, and improve reliability. The President's National Energy Policy calls for comprehensive electricity legislation that respects the role of the States and focuses on the regulation of wholesale power markets and transmission in interstate commerce.

When the Federal Power Act was written in 1935 there was virtually no interstate commerce in electricity, there was no interstate transmission grid, electricity markets were local, power plants were built near consumers, and electricity generation was perceived to be a natural monopoly.

The evolution of the electricity industry today presents a different picture. The transmission grid is both interstate and international, electricity markets encompass entire regions, almost all wholesale electricity sales are in interstate commerce, and the natural monopoly in generation has long since been disproved. The electricity industry has been swept by dramatic changes for years, investment in new transmission and generation has lagged as a result, and legislation can significantly reduce this uncertainty and strengthen the U.S. electricity industry. The time has come to modernize federal electricity laws to recognize these changes.

In order to address these changes in the electricity market, the President's National Energy Policy recommends several proposals to encourage modernization of electricity law and foster investment in both generation and transmission. First, the Department of Energy has been tasked with conducting an analysis of the nation's transmission grids in order to determine where we need more transmission and better interconnectivity and instructs DOE to consider the benefits of a national grid. A Department of Energy report on these issues is shortly forthcoming. Second, the Policy encourages FERC to develop a rate structure that would encourage the construction of additional transmission. Finally, the Policy instructs DOE to develop legislation that would provide the federal government with transmission siting authority to address situations that might arise where failure to act by a state or local government causes major constraint in an area's transmission needs. The Department of Energy has been working with both Congress and States to develop siting authority language that respects the role of the States as well as regional needs.

The recent electricity crisis in California and the West was a dramatic demonstration of the problems that exist under the status quo—problems that Congress can and should address. The time has come for Congress to reduce the tremendous regulatory uncertainty facing the electricity industry, and modernize federal electricity laws in order to make wholesale power markets more competitive, strengthen the transmission grid, increase electricity supply, lower prices, protect consumers, and improve reliability. We believe that Chairman Barton's proposed legislation goes a long way toward accomplishing these goals, and look forward to working with the Committee on this important bill.

As to the specifics of H.R. 3406:

Title I

- The Administration agrees with the policy goals of sections 101, 102 and 103.
- The Administration supports the repeal of PUHCA, as has every Administration since 1984.
- The Administration supports prospective repeal of the mandatory purchase obligation under PURPA and believes the legislative language should be amended to eliminate the ownership limits on PURPA qualifying facilities.
- The Administration supports section 142 because the Administration believes that NRC antitrust review is redundant and unnecessary and should be prospectively repealed.

Title II

- The Administration supports the policy goal of section 201 and looks forward to working with the Committee to agree on final specific language.
- With regard to section 202, the Administration believes RTOs have great potential to improve competition, secure reliability and ensure sensible regional coordination. To the degree RTOs serve those purposes, we support them.

Title III

- With regard to section 301, the Administration believes this section is an improvement over the reliability provisions of legislation approved by the Subcommittee two years ago and approved by the Senate last year.

Title IV

- The Administration agrees that FERC transmission-pricing policies should encourage increased investment in new transmission. The Administration therefore supports the legislative proposal in section 401 to direct FERC to develop a performance-based regulatory framework for transmission pricing.
- Section 402 grants FERC limited authority to issue permits to construct or modify transmission facilities under certain circumstances. The Administration supports this proposal.

Title V

- The Administration generally supports the language in Title V and looks forward to working with the Committee to agree on final specific language.

Title VI

- The Administration generally agrees with the consumer protection provisions in Title VI and looks forward to working with the Committee to agree on final specific language.

Title VII

- The Administration opposes section 702, which expands FERC's refund authority.

The President has asked for comprehensive electricity legislation which will reduce regulatory uncertainty, make wholesale power markets more competitive, strengthen America's transmission grid, increase electricity supply, lower prices, and improve reliability. We believe that this legislation is a good start on these principles and look forward to working with Congress to enact them.

At this time I would be happy to answer any questions that the Committee may have for me.

Mr. BARTON. I think that's the shortest administration statement before my subcommittee in the 3 years I have chaired it. So I appreciate the support.

We will now go to the Chairman of the FERC, Mr. Pat Wood of Texas.

STATEMENT OF HON. PAT WOOD III

Mr. WOOD. Thank you, Chairman Barton and members. When I joined the Federal Energy Regulatory Commission earlier this summer, I did so with a sense of urgency. In the aftermath of the tortuous experience in the western markets and the impacts that it had on customer faith in the concept of competition serving customers well, followed shortly after my ascension to the chairmanship with the bombing of the World Trade Center and the Pentagon and the implications upon what we redefined energy security to mean and now in the aftermath of Enron and the, I think, unfair association of its unique issues with other players in the energy market, it is very clear to me from talking to investors, from talking to customers and everybody in between that we need to get this industry clarified, and we need to make sure that the ground rules for investment and for customers and for new participants are nailed down. So I think the sense of urgency that I certainly heard from a number of the committee members this morning is one that I personally share at the Commission.

It is not a theory that we are talking about; it is real dollars. With Congress and FERC, back in the mid-1980's, the deregulation of the other great network energy industry, natural gas, began. It took about 7 years compared to the 9 years which we are in now, in electricity. But since that effort was largely wrapped-up in 1992,

tens of billions, with a "b," of dollars have stayed in customer pockets because of the successful one-two punch of introducing competition and then deregulating, getting government out of the way, a significant sector of the natural gas industry. I think that is not theory; that is a very real model that has got a lot of application to what the committee has before it in the chairman's package today.

I think that package does a lot of things. While FERC has moved forward in the areas where we do have authority today, we certainly think there are a number of areas where our authority is either not clear or is nonexistent that are very important to completing the energy infrastructure and competition-certainty picture that investors and customers need to have faith that their energy markets are working well on their behalf.

I think I will list just a few of those. Certainly, the steps that we are taking, I will be glad to discuss them along the lines that I believe Chairman Barton laid out in his statement. But the issues where we have no ability, such as on the issues of PUHCA, PURPA, demand-side management—the clarification about the issues there—and the great future of the electric industry for small-scale distributed generation. There is a provision there that I think is very important for setting some clear investment and cost recovery standards for DG. The importance of open access is not just a voluntary thing. As the court affirmed yesterday, we have the right to "lay out" on a voluntary basis. With that, Chairman Barton's bill actually says it is something that everybody should do; that also includes Federal power agencies, which up to now have not been as directly involved in the efforts to create a seamless national power grid from coast to coast.

Enforcement of liability standards is important. This bill addresses that as well, which we cannot do through the current statute. The backstop of transmission expansions, while I share the opinions of many that this may be a solution looking for a problem, it would be nice if this happens in 10-year cycles to ensure that good transmission concepts do not get forgotten or overlooked or nixed by a State that may not want to have the region improved.

And, finally, certainly, the customer protections, which do not involve my agency, but the market oversight tools that are strengthened and expanded at the end of the chairman's mark are very important provisions that I think will enhance the Commission's ability to oversee these markets. I think we are doing quite a bit on that effort. I would like to report on that later, but I think the sense of urgency also applies to today's schedule, so I will conclude now, Mr. Chairman, and look forward to any questions from the members.

[The prepared statement of Hon. Pat Wood III follows:]

PREPARED STATEMENT OF HON. PAT WOOD, III, CHAIRMAN, FEDERAL ENERGY REGULATORY COMMISSION

I. INTRODUCTION

Mr. Chairman and Members of the Subcommittee: Good afternoon. Thank you for the opportunity to speak today on the Chairman's proposed legislation, H.R. 3406, to restructure the electric utility industry to full, effective wholesale competition. This industry has changed substantially in the years since Congress enacted the Energy Policy Act of 1992, moving closer to the Congressional goal of a competitive

wholesale electricity market. However, the transition is not complete. Infrastructure investment suffers from the uncertainty of this long transition. Reliability is being tested and customers are being deprived of the financial savings and other benefits of a competitive marketplace. It is time to finish the job.

Today, I will describe briefly the significant actions taken by the Commission in recent months to do just that, and the efforts planned by the Commission in the future. I will identify those areas in which legislation could facilitate the Commission's efforts. Finally, I will discuss other significant aspects of the Chairman's proposed legislation and suggest certain modifications to the legislation.

My key point today is that successful completion of the industry's transition requires a balancing of short-term and long-term considerations. In the short term, we must take steps to ensure that the transmission grid is operated more efficiently and fairly, and is expanded when appropriate. We must eliminate unnecessary barriers to entry of new generation, big or small. We must facilitate the development of more market-based demand reduction programs. And we must take steps to ensure that the type of market problems experienced in California do not recur there or elsewhere by establishing clear, fair, balanced market rules. Taking these steps in the short term will give investors the certainty they need to make long-term commitments to new electrical infrastructure. Over the long term, this commitment to sound infrastructure and sound market rules ultimately will allow us to achieve the kind of competitive wholesale markets envisioned by the Energy Policy Act—with choices dictated by the market, not by government.

Some argue that the short-term steps envisioned by the Commission will chill infrastructure investments, not encourage them. I disagree. People will not invest in generation where they believe transmission owners will operate the grid unfairly, delay interconnections of new generation or fail to expand the grid as needed. Similarly, markets characterized by a pattern of extreme price turmoil and the risk of further governmental restrictions will not provide the certainty needed by investors. The short-term steps described below will encourage the future stability of the markets, reduce or eliminate the risk of crisis-driven governmental interventions and, thus, give investors the confidence to commit billions of dollars to building the infrastructure our nation needs.

II. REGIONAL TRANSMISSION ORGANIZATIONS (RTOS)

Electric power markets are regional in nature. For that reason, the Commission has been promoting the formation and development of a small number of RTOs. These institutions, once formed, will assure reliable minute-by-minute grid operations, optimize fair use of the "electric highway" by all users, plan for the future transmission needs of the region and help long-term supply stay ahead of long-term demand.

Two years ago, the Commission decided to move forward with RTO formation on a voluntary basis. Although that has been a more tortuous path than originally intended, it is drawing to a close with utilities in all regions of the country coalescing around organizations of appropriate scope, governance and configuration. But if any party challenges this progress in courts, then Congress should make clear its intent that these organizations are its preference. This will save the industry years in the courts, ensure customers get the billions of dollars of savings that a competitive power market can deliver during that time, and most importantly, rebuild to secure and reliable levels a bedrock industry that has suffered inadequate investment in the past decade.

Recently, the Commission clarified its policies and plans on RTOs. In an order issued last month, the Commission indicated that it intends to complete the RTO effort on two parallel tracks. The first track will be to resolve issues on scope and governance in pending cases; the second track will be a rulemaking to standardize the market design for public utilities, to be implemented by RTOs. The Commission has also begun forming state-federal regional panels as a structured forum for constructive dialogue with state commissions on RTO development. We hope to expand these panels in the future to discuss other joint concerns. The Commission is updating cost-benefit studies on RTOs (with input on the analysis from a diverse panel of state commissioners) and will establish in future orders the timelines for continuing RTO progress in each region. We expect to address the RTO structure in the large Midwestern region of the country at our December meeting.

In establishing the characteristics and functions of RTOs and the procedures for obtaining Commission approval of an RTO, the Commission relies on sections 205 and 206 of the Federal Power Act. These sections are the Commission's fundamental authority for ensuring that the rates, terms and conditions of transmission in interstate commerce by public utilities are just, reasonable and not unduly discrimina-

tory or preferential. In addition, the Commission has relied on its authority under section 203 of the Federal Power Act to review proposed transfers of operational control over jurisdictional transmission facilities. While some may question the Commission's as-yet-unexercised authority to require the formation of RTOs, there is no legitimate debate about the Commission's authority to oversee voluntarily-formed RTOs.

I strongly support the formation of RTOs. RTOs will provide significant benefits to electric utility customers across our Nation. I believe the best legislative approach at this time would be for Congress to adopt a provision permitting the Commission to require RTOs where it finds such RTOs to be in the public interest. This simple step would avoid problems that could arise if Congress codifies extensive and cumbersome procedures for formation of RTOs and detailed standards for those RTOs; it also would allow the Commission to adapt the RTO procedures and standards appropriately over time, as circumstances change.

Section 202 of the Chairman's proposed legislation would codify more prescriptive procedures. Section 202 would require all "transmitting utilities" (a term that includes both investor-owned utilities and public power/electric power cooperative utilities) to participate in an RTO. A utility not in a Commission-approved RTO upon enactment of the bill must submit an application to form or join an RTO. If the Commission finds the application does not meet the standards specified in the bill, the Commission, in consultation with affected State authorities, must propose modifications. The Commission cannot mandate formation of, or participation in, an RTO except under these provisions. If an applicant asks, the Commission must hold an evidentiary hearing on the proposed modifications. Subsequently, the utility has a right to seek appellate review, during which time the Commission's order is stayed. If the court finds the Commission's decision is supported by a preponderance of the evidence, the court must uphold the Commission's decision. Otherwise, the Commission must order the utility to participate in its proposed RTO without modification.

If Congress decides to proceed with the more elaborate process laid out in Section 202, I have specific concerns about aspects of the provision. First, I do not support giving a single RTO applicant the unilateral right to require an "evidentiary" (trial-type) hearing instead of "paper" hearings. While evidentiary hearings may be appropriate in certain cases, most cases can be fairly resolved much more quickly based on paper submissions and non-trial type procedures. Further, because the provision requires a "stay" of a Commission RTO order pending court review, and a Commission order likely would address one application filed on behalf of all the participants in the region, this provision could allow a single applicant to stall the creation of an RTO and an effective wholesale market for many years, raising costs for other applicants and all regional electricity consumers. Formation of workable wholesale markets will be more likely and swift without these provisions.

Second, I do not support the requirement for a "preponderance" of the evidence instead of "substantial" evidence supporting the Commission's decisions. The "substantial evidence" test has been the basis for court review under the Federal Power Act since 1935, and I see no reason why a different standard is now needed for this one category of cases.

Third, I see no reason for the provision resembling "baseball-type" arbitration, under which the Commission either must prevail in court or accept without modification the utility's proposal. Judicial review of Commission decisions sometimes yields a remand to the Commission for a fuller explanation or more fact-finding, and I see no reason to preclude that option here. In general, having RTO formation dependent upon only transmission-owning applicants, rather than all wholesale market players, leads to a less balanced and robust marketplace. A successful wholesale market model must have strong stakeholder participation and oversight at its core.

Section 202 also specifies the standards for RTOs. These standards are drawn partly from the Commission's Order No. 2000. While it might be appropriate to codify some general standards (such as the basic independence requirement), other standards and the details of implemention are not appropriate to legislate. As market circumstances and structures change, and as the Commission gains experience with market behavior, the Commission needs the flexibility to adapt its rules over time to ensure that markets remain robust and customers' interests are safeguarded; a rigid, legislative codification of standards could preclude this flexibility.

If Congress does codify such standards, certain elements of section 202's standards raise other concerns. For example, the bill requires a proposed RTO to have "sufficient generation within the RTO's boundaries to serve the load within such boundaries." While I agree that this is desirable, exceptions may be appropriate in certain circumstances, and section 202 should allow exceptions deemed appropriate by the Commission.

The bill allows each public utility in an RTO to file "original or amended rates concerning transmission service on such utility's facilities." This is contrary to the Commission's requirement in Order No. 2000 that the RTO have the exclusive right to make rate filings related to the rates, terms and conditions of transmission services it provides to transmission customers in the region. While the Commission found that transmission owners have the right to file to recover from the RTO their own revenue requirements, it also found that it would be contrary to the basic RTO independence requirement if transmission owners could control the RTO's rate filings.

I note that section 3 of the bill would define a "market participant" as "any entity that generates, sells, or aggregates electric power (other than State-ordered transition or default service) that is transmitted on the transmission system operated by a regional transmission organization." As above, I do not believe Congress should legislate a definition of "market participant," since such a definition may need to be changed over time as we gain experience with market behavior and new types of market institutions and activities (for instance, it excludes energy service companies that could aggregate demand and "negawatts" and offer price-responsive demand opportunities in wholesale and retail electric markets). Further, with respect to the specific definition in section 3, I disagree with the provision on State-ordered transition or default service. This provision appears to assume that, unlike other market participants, utilities providing such services are economically indifferent to the grid's operation because their profits or growth potential will not depend on the cost of their power supplies. Depending on the terms under which they provide this service, however, utilities may have the same economic incentive as other market participants to benefit from grid operations that provide them preferential access to low cost supplies.

If Congress does legislate a definition, a better approach to defining "market participant" is the definition adopted by the Commission in Order No. 2000, which includes:

> (i) Any entity that, either directly or through an affiliate, sells or brokers electric energy, or provides ancillary services to the Regional Transmission Organization, unless the Commission finds that the entity does not have economic or commercial interests that would be significantly affected by the Regional Transmission Organization's actions or decisions; and
>
> (ii) Any other entity that the Commission finds has economic or commercial interests that would be significantly affected by the Regional Transmission Organization's actions or decisions.

18 CFR 35.34 (b)(2) (2001). This approach is more flexible than the bill's assumption that providers of State-ordered transition or default service always lack economic or commercial interests that would be significantly affected by the RTO's actions or decisions.

Finally, three other provisions raise concerns. First, the legislation would require the Commission to accept a cost/benefit analysis submitted by an applicant to support its proposed scope and configuration, unless the Commission finds the scope and configuration does not meet the statutory requirements by a preponderance of the evidence. Cost-benefit analyses are easily susceptible to manipulation of assumptions and data to achieve a desired result, so any analysis should be tested and verified rather than automatically accepted. Second, the standard for the Commission's findings should be "substantial evidence," not a preponderance. Third, the legislation would preclude the Commission from requiring any change to the governance or scope of an RTO finally approved without condition before the law's enactment. This provision would prevent the Commission from responding to changed circumstances warranting modifications in the RTO's governance or scope.

III. INTERCONNECTIONS

The current lack of standardized interconnection agreements and procedures means that every new generator can be forced to expend time and money negotiating the terms and conditions of an interconnection arrangement, before it can have any certainty about its ability to deliver power to the grid. This uncertainty is a significant barrier to entry for new generation.

To remedy this problem, on October 25, 2001, the Commission issued an Advance Notice of Proposed Rulemaking (ANOPR) requesting comments on a standardized generator interconnection agreement and procedures. The ANOPR strongly encouraged interested parties to pursue consensus on the issues and presented a model that was used successfully in Texas as a strawman to facilitate the process. Parties must file this Friday a document describing the consensus views and any remaining disagreements; any additional comments are due by December 21, 2001. I under-

stand that industry is reaching consensus on many issues in the ANOPR process but that they may request a brief extension of time to complete their negotiations. I assure you that I will be receptive to a brief extension if it is evident that progress is being acheived toward a consensual resolution of these issues.

The Commission expects to use the outcome of the ANOPR as the starting point for a rulemaking to standardize interconnection protocols. This rulemaking will clarify and simplify the procedures for interconnecting new generation, thus promoting competition and benefitting customers.

The Commission has held that interconnection is a component of transmission service. Thus, the Commission's authority to standardize interconnection protocols derives from sections 205 and 206 of the Federal Power Act, under which the Commission oversees the rates, terms and conditions of jurisdictional transmission service.

Section 101 of the Chairman's proposed legislation establishes requirements for interconnections with distribution or transmission facilities. Section 101 addresses the generator's right to interconnect and its duty to pay interconnection costs, the availability of backup power and the rates, terms and conditions for such power. The Commission is required to promulgate the technical standards for interconnections. The Commission is also required to establish the process and procedures for interconnection with transmission facilities. A transmitting utility or regional transmission organization is exempted from the Commission-established process and procedures upon showing that "substantially comparable interconnection procedures and agreements have previously been filed with and approved by the Commission for interconnection with that entity." But this exemption provision would nullify the benefits of standardization by forcing the Commission and utilities to litigate over which "substantially comparable" non-standard provisions are acceptable and exempt from the standard, and keep non-standard agreements in place for years.

As stated above, standardization of rules and procedures for interconnecting all new generation and expansions of existing generation is a good policy, both for traditional power plants and for small-scale distributed generation. This is a high priority goal for the Commission. Standardization will help minimize the costs and barriers to entry for new and expanded generation, which is critical to a robust competitive marketplace and the realization of lower electricity costs for end users.

As written, Section 101 may be overly prescriptive and impede the Commission's ability to adapt its approach as the industry changes over time. A more general approach may be preferable. If the current approach is retained, I suggest another change in Section 101, pertaining to the right to backup power for generators interconnecting with distribution facilities unless the local distribution utility allows open access to its facilities. In this context, open access is defined as access "that is not unduly discriminatory or preferential." However, the Commission found in establishing wholesale open access to public utilities' transmission facilities that the lack of a published tariff of rates, terms and conditions was a significant obstacle to service. The Commission required public utilities to provide open access transmission service by tariff. Accordingly, I believe a local distribution utility must offer open access service by tariff before it can be relieved of its duty to provide backup power.

IV. TEST FOR GENERATION MARKET POWER

Since beginning to grant market-based rates (rate deregulation) to public utilities in the 1980s, the Commission primarily focused on the applicant and employed a "hub-and-spoke" analysis to determine whether an individual entity and its affiliates have generation market power. In a hub-and-spoke analysis the applicant computes its market share of generation in a particular market. While the Commission did not use a "bright line" test, it looked to a benchmark for generation market power of whether a seller had a market share of 20 percent or less in each market.

In public deliberations shortly after I joined the Commission this summer, which were informed in part by our experiences in California, my colleagues and I questioned the usefulness of the hub-and-spoke test as a tool to identify the potential for the exercise of harmful market power. After reviewing the issue over the summer, the Commission instructed our staff at an Open Meeting on September 26th to refine the hub-and-spoke test on an interim basis for future applications and for current certificate holders' three-year updates, while contemplating a rulemaking to address the issue on a more permanent basis.

The revised test, the Supply Margin Assessment (SMA), improves upon the hub-and-spoke in two critical ways. First, unlike the hub-and-spoke, the SMA excludes from the analysis of the relevant market those sellers who are physically precluded from participating in that market by transmission constraints. Second, instead of

deriving an overall market share, the SMA determines whether any part of a seller's capacity is "pivotal," i.e., must be used to meet the market's peak demand. For example, if peak demand in a market is 100 megawatts, total capacity in the market (including the applicant's) is 120 megawatts and the applicant owns 60 of the 120 megawatts, the seller's capacity is pivotal because at least 40 megawatts of the seller's capacity is needed to meet peak demand. By contrast, a seller with only 15 megawatts would not be pivotal because peak demand in the market could be met fully by other suppliers.

A company that fails the SMA screen is subject to mitigation to ensure that the company does not exercise market power by withholding its capacity from the market. Under this mitigation, the company must offer for sale, a day in advance, any short-term capacity which is not already committed for sale or use by the company. The price for any such sales is based on a "split-the-savings" approach which divides the economic benefits of the transaction equally between the seller and buyer. This test is administratively preferable to the more intensive cost-of-service based calculation traditionally used, for example, to set retail rates in regulated states. The company must also post offers to sell long-term energy products (in addition to the daily products noted above).

This mitigation is carefully tailored to apply only to the extent necessary. For example, mitigation applies only in the specific market where the utility has market power, and the utility (and its affiliates) are still allowed to sell at market-based rates in any areas where they do not possess market power. The mitigation applies only to capacity that is not committed a day in advance ("spot" sales), and does not affect a utility's authorization to sell its capacity under long-term contracts. Finally, the SMA does not apply to sales in an RTO or an Independent System Operator (ISO) with Commission-approved market monitoring and mitigation.

The Commission soon will initiate a generic proceeding to consider long-term changes to its analysis for generation market power. In the meantime, the SMA and its carefully-crafted mitigation are a substantial improvement on the prior approach, while continuing to allow sellers to compete freely in markets where they lack generation market power. I would note that the interim SMA market power screen is subject to rehearing, and the Commission will consider carefully any requests for rehearing.

Apart from these efforts, the Commission recently proposed a new condition on its authorization of market-based rates for electricity producers. Under this proposal, a seller would be subject to refunds or other appropriate remedies if it engages in anti-competitive behavior or exercises market power. This condition would be triggered only when the seller engages in inappropriate conduct, not when market problems are caused by poor market rules or other generic dysfunctions. The Commission adopted a similar condition to help address the market problems in California and the Western United States, and is now proposing to extend the condition to public utilities elsewhere. The Commission is receiving public comments on this proposal and will fully consider the comments before making a final decision.

V. RELIABILITY

Section 301 of the Chairman's proposed legislation provides for Commission certification of an electric reliability organization (ERO) to develop and enforce reliability standards applicable to all users, owners and operators of the bulk power system. The bill specifies the criteria for the ERO. The ERO would be required to file its proposed reliability standards with the Commission, and the Commission would need to act on those proposals within specified time periods. The ERO and the Commission would have to rebuttably presume that a proposal from a regional entity for a reliability standard applicable on an interconnection-wide basis is just, reasonable, not unduly discriminatory or preferential and in the public interest. The ERO would have authority to enforce its standards, subject to Commission review.

Section 301's approach to reliability is a step in the right direction. Although I have not seen problems with the current voluntary process, parties inform me that federal legislation is needed to ensure the enforceability of the reliability standards. While some technical clarifications or modifications to the proposed language might be useful, as a general matter section 301 takes a reasonable and efficient approach to this problem.

VI. TRANSMISSION JURISDICTION

A. Open Access

"Separate but equal" transmission is inherently unequal. Transmission of electric power is interstate commerce and should be fairly recognized as such. And all users of transmission service should be treated equally, provided they pay for it. One need

look no further than Chairman Barton's home state to observe the positive impact that having clear rules from a single regulator has had on needed investment and expansion of the grid.

Section 201 of the Chairman's proposed legislation would allow the Commission to require all public utilities and transmitting utilities to offer open access transmission services. In recent years, open access transmission services by public utilities have increased competition in wholesale power markets significantly. Extending this requirement to the large portion of the grid owned or operated by transmitting utilities that are not public utilities will further increase competition. I believe this can be done in a manner that respects the historic independence of certain public power utilities while ensuring that a consistent approach is applied to all users of the interstate grid, to further wholesale electric competition and benefit all electricity customers.

I support Section 201 but suggest minor changes. First, for reasons explained above, section 201 should be clarified to provide that the Commission can require open access transmission services *by tariff,* and can require such tariffs to be on file with the Commission so that potential transmission customers have available for public inspection, in a centralized place (the Commission), all open access services being offered and the rates, terms and conditions of such services.

Second, section 201 would require the Commission to ensure that the rates charged for open access services by a transmitting utility other than a public utility are comparable to the rates the utility charges itself. The Commission would be given authority to review and remand the rates for revision where necessary, but would not have the authority to modify the rates directly. The Commission could be given the authority to modify the rates where necessary, to prevent any delay in the establishment of rates in compliance with section 201.

B. Stranded Costs

Section 201 also would require the Commission to authorize recovery of wholesale stranded costs caused by a "municipalization," and specifies precisely how the Commission should determine the "reasonable expectation period" for purposes of calculating the stranded costs. I am concerned about the latter provision, and believe that the calculation of stranded costs should be left to the Commission's discretion based on all relevant circumstances in a particular case. The Federal Power Act does not prescribe how to calculate stranded costs except in requiring that rates must be just, reasonable and not unduly discriminatory or preferential. This statutory approach should not be changed.

C. Transmission Siting

Section 402 would allow the Commission to authorize construction or modification of transmission facilities if it makes each of three findings: (1) the relevant State lacks authority to approve the action, has withheld or delayed approval for more than a year or has conditioned its approval such that the action is economically infeasible; (2) the facilities being authorized will be used for transmission of electric energy in interstate commerce; and (3) the action is consistent with the public interest, as proposed or conditioned.

A FERC backstop such as this may well be the best decision, but there are others that could work. Since these siting issues are largely regional, the RTO could be the backstop instead of FERC. This keeps the relevant determinations of need, environmental issues and landowner concerns closer to the affected citizens. Or, it may be enough to simply require states to make final decisions (pro or con) within a fixed time-frame. Some states specifically require that a transmission line approval by that state be shown to provide direct benefits to the citizens of that state. This sort of provision may make it difficult for a state to approve routing of a line that has significant regional benefits but not specific local benefits.

VII. OTHER ISSUES

A. Investigations, Refunds and Penalties

Section 702 of the proposed bill expands section 206 of the Federal Power Act to allow the Commission to order refunds not only by public utilities but also by other entities that provide transmission service or power to a public utility. Section 703 expands the criminal penalties authorized under section 316 of the Federal Power Act. Section 703 also broadens section 316A of the Federal Power Act so that civil penalties are authorized for violations of any provision under Part II of the Federal Power Act, instead of only sections 211, 212, 213 or 214.

These provisions are helpful changes to the Federal Power Act. The recent problems in wholesale markets in California and the Western United States demonstrated the need for such changes.

B. PUHCA

Sections 111-125 of the Chairman's proposed legislation repeal the Public Utility Holding Company Act of 1935 (PUHCA) and replace it with increased access by the Commission and state regulators to certain books and records. This is appropriate. PUHCA was enacted primarily to undo harms caused by certain holding company structures that no longer exist. In the 65 years since PUHCA was enacted, utility regulation has increased substantially under the Federal Power Act (including oversight of corporate restructurings such as electric utility mergers, discussed below), federal securities laws and state laws, all of which ensure that customers are fully protected.

C. PURPA

Sections 131-134 of the Chairman's proposed legislation repeal prospectively the mandatory purchase obligation in the Public Utility Regulatory Policies Act of 1978 (PURPA). As indicated in the bill's proposed findings, PURPA's "forced sale" requirement is no longer necessary to promote competition, in light of the availability of open access transmission, and more often serves to distort competitive outcomes. Thus, I agree that Congress should repeal PURPA but "grandfather" existing PURPA contracts. To provide a smoother transition for parties which made investments under the expectations created by PURPA, it may be appropriate to limit its repeal to those states where all generation entities have the ability to sell their output to the widest possible range of customers.

D. Mergers

Section 141 would repeal section 203 of the Federal Power Act, the authority under which the Commission reviews proposed mergers and other dispositions of public utility facilities. This provision may not be in the public interest. The Commission deals with the electric utility industry on a daily basis and much more closely than the federal antitrust agencies. Thus, the Commission is better able to identify and remedy any harmful effects of mergers and other dispositions. Our efforts do not duplicate those actually being performed today by other merger reviewing agencies. The Commission has used its section 203 authority as intended by Congress to ensure that mergers and other dispositions are consistent with the public interest. Also, in recent years, the Commission has acted quickly on merger applications, almost always within 90 days after receiving public comments on a proposed merger.

In addition, it may be a good idea to clarify the Commission's authority to review mergers involving only generation facilities and mergers of holding companies with electric utility subsidiaries. The increasing amount of competition in power generation markets makes this more than an academic question. But, to be fair, there are other, less blunt tools that the Commission has to address generation market power.

VIII. CONCLUSION

The electric utility industry has come far since the enactment of the 1992 Energy Policy Act. The Commission is moving ahead aggressively to achieve that legislation's vision of fully competitive wholesale markets. Additional legislation will help us get there faster. I support the Commission-related provisions of Chairman Barton's proposed legislation, with the modifications described above. This legislation will help all electric customers realize greater benefits from wholesale competition.

Mr. BARTON. Thank you, Chairman.

We now go to Commissioner Breathitt from the great State of Kentucky.

STATEMENT OF HON. LINDA K. BREATHITT

Ms. BREATHITT. Thank you, Mr. Chairman and members of the subcommittee. I appreciate the opportunity to appear before you today to discuss your energy restructuring legislation. I believe it is important for Congress and FERC to work in tandem to accomplish the critical goal of ensuring the development of a competitive wholesale electric power market that is fair and efficient and that benefits consumers.

While I believe FERC has made great strides in the effort to increase wholesale competition over the past several years, I welcome

congressional guidance through legislation that assists in articulating and clarifying the steps that must be taken toward this end.

I am supportive of the policies underlying H.R. 3406, and I am pleased to see that it is consistent with many of the comments I have made in past hearings before this subcommittee. As I set forth in more detail in my written testimony, I welcome congressional clarification of FERC's authority with respect to RTOs and expansion of our authority in the areas of civil and criminal penalties for violations of the Federal Power Act. I support the repeal of PURPA and PUHCA, and I agree that interconnection rules should be standardized. I also believe the bill's approach to transmission siting represents a great improvement over the current jurisdictional scheme.

I would like to take this opportunity to highlight an aspect of H.R. 3406 that I cannot support, and that is repeal of Section 203 of the Federal Power Act, which embodies the Commission's merger review authority. I don't agree with the basic underlying premise that FERC's merger review is redundant. All merger reviews are not created equal. Unlike any other agency with jurisdiction over mergers, our agency uses a different test, and that is the public interest standard. This is significantly different and distinct from the "no harm to competition" review employed by other agencies, and I urge this subcommittee to continue allowing FERC to protect the public in this regard.

With this exception, while my testimony highlights various details on which I suggest minor changes, I believe that your work on this document ultimately will serve to aid the Commission and the public as we move ahead with our agenda. I didn't address the other topics that you said may likely come up today. I stuck to your legislation, and I will happy to get to those others if the time comes.

[The prepared statement of Hon. Linda K. Breathitt follows:]

PREPARED STATEMENT OF HON. LINDA K. BREATHITT, COMMISSIONER, FEDERAL ENERGY REGULATORY COMMISSION

Mr. Chairman and Members of the Subcommittee: I appreciate the opportunity to appear before you today to discuss the Subcommittee's proposed energy restructuring legislation. I believe it is important for Congress and the Federal Energy Regulatory Commission (FERC) to work in tandem to accomplish the critical goal of ensuring the development of a competitive wholesale electric power market that is fair and efficient and benefits consumers. While I believe FERC has made great strides in the effort to increase wholesale competition over the past several years, I welcome Congressional guidance through legislation that assists in articulating and clarifying the steps that must be taken toward this end.

My testimony today will comment on H.R. 3406 and highlight specific aspects of the proposed legislation that I consider to be especially important from the perspective of a federal energy regulator. As a general matter, I am very supportive of H.R. 3406. I have testified before this Subcommittee many times on restructuring issues, and I am pleased that this proposed legislation is largely consistent with many of the views I have expressed. I am also pleased that the bill would have the effect of promoting small-scale renewable generation. As I will discuss in greater detail below, however, there is one important exception: I do not support the proposed repeal of section 203 of the Federal Power Act (FPA).

Title I of the proposed legislation deals with electric supply. Among the provisions of Title I, I would like to address my comments to interconnection, the Public Utility Holding Act of 1935 (PUHCA), the Public Utility Regulatory Policies Act of 1978 (PURPA), and merger review. I have previously testified before this subcommittee that interconnection rules should be clarified and standardized in order to ensure that new sources of generation are able to interconnect to the transmission system.

The Commission accelerated this process of standardization in October with the issuance of an Advanced Notice of Proposed Rulemaking (ANOPR) addressing procedures and protocols for interconnection. The ANOPR encourages parties to reach consensus on non cost-related issues of transmission interconnection and uses as a "strawman" the ERCOT model as supplemented by current Commission interconnection policy. Reports of the progress being made are positive, and I support issuance of a NOPR as soon as possible. The Commission's intention is to instruct parties to take up the issues of cost responsibility for transmission interconnections in the second phase of the transmission interconnection rulemaking.

Section 101 of the proposed legislation would decide the major issue of cost responsibility by assigning system upgrade costs to the generator. I believe these pricing decisions need to be made carefully and with consideration of the multiple factors at issue. Although this legislative process certainly is one forum for deciding this important issue, the cost responsibility aspect might also benefit from comments and a consensus process such as the Commission plans for the second phase of our rulemaking. I expect the second phase, dealing with cost issues, will be more difficult and contentious; many states already are expressing their views.

Section 101 of the proposed legislation also requires the Commission to promulgate the technical standards for generators interconnecting with distribution facilities. Although it is no modest undertaking to establish national standards for distribution interconnections, I do believe reducing obstacles for small-scale distributed generation can produce good results. Distributed generation can increase options for consumers and would provide added reliability to the grid. Standards for all players, as well as the net metering provisions included in this legislation, may encourage the growth of this fledgling movement toward decentralization of the electric grid. Of course, we should expect the states to insist on a process that allows their opinions and concerns to be heard since this section shifts jurisdiction to the federal level.

The proposed legislation repeals PUHCA and replaces it with increased access by the Commission and state regulators to certain books and records. I support this legislation. The proposed legislation also repeals prospectively the PURPA mandatory purchase obligation. I support the repeal of the mandatory purchase requirement in Section 210 of PURPA. I also support proposed section 133 of the bill, which would "grandfather" existing PURPA contracts.

I would like to highlight Subtitle D of Title I, which would eliminate FERC's merger review authority now embodied in section 203 of the FPA. This is the single aspect of this proposed legislation that I cannot support. The title itself of Subtitle D, "Redundant Review of Certain Matters," reveals my basic concern in this regard: I do not agree that FERC merger review is redundant. All merger reviews are not created equal. FERC's FPA "public interest" standard is different from the "no harm to competition" antitrust standard of the Sherman Act and the Clayton Act. The relevant information required for the type of review conducted by FERC is not the same information required by another agency conducting antitrust review of the same merger. While the same merger may be reviewed by various agencies, the analyses are not parallel; standards and requirements vary from agency to agency.

I believe it is important for FERC to continue its public interest-focused merger analysis, which looks at a merger's effects on rates, regulation, and competition. FERC, in its regulatory role, is particularly attuned to the issues that may arise as a result of competition and industry consolidation, including technical issues and new kinds of mergers that may lead to the blurring of traditional utility services with other business lines. By acknowledging these issues, I believe that FERC has developed a dynamic and flexible process—one that is required in today's market. I urge the Subcommittee to continue to allow FERC to retain the authority to protect the public in this respect.

Title II of the proposed legislation deals with transmission operation. Section 201 of the proposed legislation would allow the Commission to require all public utilities and transmitting utilities to offer open access transmission services, extending the requirement for open access to transmitting utilities that are not public utilities. As I have testified on other occasions, I believe it is important to have equal and open access to all transmission at nondiscriminatory rates and comparable terms and conditions. At the same time, the public power sector has expressed concerns unique to its status, and these concerns should be addressed with respect to sections 201 and 202. Chairman Wood's testimony requests a change to the legislation to allow all tariffs for open access transmission service be on file with the Commission. I share the Chairman's concerns on these issues and support his testimony in this regard.

Section 202 addresses Regional Transmission Organizations (RTOs). There is no more important effort underway at FERC today than the formation of RTOs. Since

the Commission began promoting RTOs as a means to remove barriers and impediments present in wholesale electricity markets, I have been fully committed to the goal of RTO formation. While there is room for disagreement on the best path to attain the goal of fully functioning RTOs, FERC is very actively pursuing the completion of the development of RTOs with clear responsibilities, independence, and sufficient scope.

When the Commission issued Order No. 2000 in December 1999, we decided to adopt an open and collaborative process that relied on voluntary regional participation. Since that time, I have strongly urged that FERC not depart from the basic philosophies embodied in Order No. 2000, particularly in the absence of a formal decision to do so, informed by the views of interested parties and state commissions. In my view, sufficient question remains over FERC's authority to mandate the formation of, or participation in, RTOs, such that any moves on our part toward a mandate will be counterproductive to FERC's ultimate goals. My concern is that this lack of clarity could lead the industry and the Commission to divert resources away from the important task of RTO implementation, and instead toward expensive and time-consuming litigation over FERC's authority. I therefore support Congressional clarification of FERC's authority with respect to RTOs.

Proposed section 202 mandates that all transmission utilities—both investor-owned utilities and public power/electric power cooperative utilities—participate in an RTO. To the extent this direction will eliminate any existing uncertainty regarding FERC's authority and permit RTO formation to proceed expeditiously, I support it. Proposed section 202 also requires FERC to establish uniform market rules, including the establishment and enforcement of "seams" agreements. This direction is consistent with a generic rulemaking proceeding that FERC already has announced.

While the RTO standards embodied in the proposed legislation are, for the most part, consistent with those established in Order No. 2000, I believe it is possible that RTO procedures and standards may need to be adapted over time. In his testimony, Chairman Wood suggests that instead of codifying detailed standards and procedures for implementation of RTOs, additional flexibility for FERC to oversee an adaptive process might be warranted. Chairman Wood advocates a legislative approach that would have Congress adopt a simple provision permitting the Commission to require RTOs where it finds such RTOs to be in the public interest. I believe this approach would serve to remove existing uncertainties, while preserving FERC's ability to tailor its RTO program to an increasingly dynamic marketplace.

If Congress decides to take the approach of codifying RTO standards and procedures, Chairman Wood's testimony outlines several concerns regarding (1) the right of a single RTO applicant for an evidentiary hearing; (2) the requirement for "preponderance" of the evidence supporting FERC decisions; (3) the judicial review provision; (4) the requirement for a proposed RTO to have "sufficient generation within the RTO's boundaries to serve the load within such boundaries;" (5) the right of each pubic utility in an RTO to make rate filings; (6) the definition of "market participant;" and (7) the preclusion of FERC modification to the governance and scope of an RTO approved before the law's enactment. I share the Chairman's concerns on these issues and support his testimony in this regard.

Title III of the proposed legislation provides for Commission certification of one electric reliability organization to develop and enforce reliability standards for the bulk-power system. I agree that the voluntary reliability system, which has been in place for over three decades, should be replaced with one in which a self-regulated independent reliability organization, with oversight by the Commission, establishes and enforces mandatory reliability standards. I especially support the provisions of section 216(e), which provides for sanctions and penalties for failure to comply with reliability rules. In my view, such a change in the manner in which the reliability of the interconnected grid is overseen and managed is required in order to ensure a competitive bulk power market.

The provisions of Title IV direct the Commission to conduct a rulemaking to establish incentive and performance-based rate policies for expansion of transmission networks to promote expansion of the transmission grid to support the growth of competitive markets. Section 401 states that such policies should encourage the deployment of new transmission technologies to increase capacity of existing networks and to reduce line losses; promote environmentally sound transmission design techniques; and promote the efficient use of transmission systems on a real-time basis. I believe that the Commission's transmission rate policies should encourage and promote such policy objectives. I would point out that I believe these goals may be achieved through rate policies other than incentive or performance-based rates. In my view, policies such as allowing a reasonable return on equity or accelerated depreciation for new technologies would act to encourage such investment.

Section 402 would give the Commission a "backstop" role in transmission siting. I believe that this is certainly an improvement over the present jurisdictional scheme, in which the Commission has no role in the permitting and siting of new transmission facilities. However, as I have testified previously, my primary concern with a backstop role for the Commission is that such an approach could result in costly and inefficient duplication of processes, records, and efforts by the various decisional authorities involved in transmission siting.

My preference would be for FERC to be granted federal eminent domain authority similar to the authority the Commission exercises with respect to the siting of interstate natural gas pipelines under the Natural Gas Act. The Commission could develop procedures to ensure cooperation with the states and provide for regional participation. I believe that this more centralized approach is preferable from an efficiency standpoint, and will result in less bureaucracy and more timely decisions for transmission providers and consumers. I am not advocating that the Commission should have siting authority for electric distribution lines or power plants. I believe that state governments are best positioned to make those determinations.

Finally, I would like to acknowledge the provisions of Title VII of the proposed legislation. These provisions strengthen the Commission's authority to assess civil and criminal penalties for violations of the FPA and increase the level of such penalties. I have advocated such changes and believe they will greatly aid the Commission in fulfilling its regulatory responsibilities.

In conclusion, I again thank the Subcommittee for this opportunity to comment upon the Subcommittee's proposed legislation. As I have testified in previous hearings before this Subcommittee, the Commission must have sufficient authority to advance its goals of achieving fair, open and competitive bulk power markets. I believe that this legislation, with the modifications I have suggested, would clarify our authority and greatly assist the Commission in realizing the benefits of wholesale competition.

Mr. BARTON. Thank you.

We now welcome our new Commissioner, Commissioner Nora Brownell from the great State of Pennsylvania, from Harrisburg to Washington. I think this is your first time to testify before this subcommittee. Is that correct?

STATEMENT OF HON. NORA MEAD BROWNELL

Ms. BROWNELL. Actually, it is my second as a Commissioner and then a few times as a State commissioner, but I am glad to be back.

Mr. BARTON. We are glad to have you. Your statement is in the record, and we will ask you to elaborate on it for 6 minutes.

Ms. BROWNELL. And perhaps the next time we come back it will be to celebrate the passage of a comprehensive energy bill.

I am going to be quick, because I know that the committee has a lot of questions, and there are a lot of complex issues to discuss. But I would note that events of the past few months—September 11, the meltdown of Enron, the confusion of the consumer market—have caused us all to evaluate what we do and how we do it. But I believe we are at a critical juncture in the development of energy markets that are needed to support the continued growth of a digital economy. The issues are complex, the answers are not easy, but they are issues that have a long-term impact on our country.

We can succumb to inertia and the fear of change, and we can leave the American public saddled with an inadequate, inefficient electric system or we can complete the transformation of that industry into the economically competitive, reliable, technologically vibrant marketplace that this Nation's consumers deserve. I believe that comprehensive energy legislation and the work that we are doing at FERC can provide the certainty and reliability that all stakeholders need, that consumers need to have confidence in the

system, that investors need to invest in the system and that new technology providers need to introduce what I think is a vibrant new future that we have not even seen yet.

To accomplish this, I think we need large Regional Transmission Organizations. I think we need to ensure there is sufficient infrastructure, and we need to guarantee there are equitable, well-understood business rules that reflect the realities of a restructured market. There is much in this bill that I support and have articulated that in my statement, and I really applaud you for your vision and the comprehensive nature of this bill. I do have concerns over some of the limitations that this might put on FERC in establishing RTOs and the rules under which they function, and I do have some concerns about our merger authority. But I do believe that we can work together with this agency and the other agencies represented here to get the answers that we need and to have this train finally arrive at the station since it left so long ago.

[The prepared statement of Hon. Nora Mead Brownell follows:]

PREPARED STATEMENT OF NORA MEAD BROWNELL, COMMISSIONER, FEDERAL ENERGY REGULATORY COMMISSION

I. INTRODUCTION

Mr. Chairman and Members of the Subcommittee: Thank you for the opportunity to share my thoughts on H.R. 3406 as well as the Commission's recent actions concerning wholesale electricity markets. We are at a critical juncture in the development of energy markets to support the growth of a digital economy. We can succumb to inertia and fear of change, and leave the American public saddled with an inadequate, inefficient electric system. Or, we can complete the transformation of that industry into the economically competitive, technologically vibrant marketplace that this nation's consumers deserve. I, for one, am committed to the latter course of action.

Passage of a comprehensive energy bill will certainly settle the many concerns created by the lack of a long-term energy policy for our country. I also believe the resolution of the issues related to the restructuring of the electricity markets will, in fact, act as an economic stimulus and unleash capital for the development of infrastructure and new technologies. I also believe that we at FERC must lay out a clear strategy for completing the transformation of electricity markets. Not only is investment constrained, but business plans are hampered by uncertainty. I am convinced that the prerequisite to success is creation of a clear and cogent course of action that will bring certainty and stability for all of the stakeholders by: (1) establishing large Regional Transmission Organizations (RTOs); (2) ensuring there is sufficient infrastructure; and (3) ensuring there are equitable, well understood business rules that reflect the realities of a restructured marketplace.

There are many provisions in H.R. 3406 that I support as consistent with this course of action, including the call for standardization of interconnection procedures, the establishment of minimum federal net metering standards, the repeal of the Public Utility Holding Company Act (PUHCA) and the Public Utility Regulatory Policies Act (PURPA), the increase in enforcement tools, and the grant of backstop transmission siting authority to the Commission as well as the authority to require all transmitting utilities to offer open access transmission service. I commend the continued leadership and hard work of the members of the Subcommittee. I would, however, suggest that Section 202, concerning the formation of RTOs, and Section 141, repealing Commission review of mergers, be amended.

II. SECTION 202—RTO FORMATION

A. RTO formation has been delayed at the expense of electricity customers

Large, independent RTOs can improve grid reliability by facilitating transmission planning across a multi-state region, create better pricing mechanisms such as eliminating "pancaking", improve efficiency through better congestion management, and attract investment in infrastructure by facilitating regional consensus on the need for construction. Consistent with the Energy Policy Act of 1992, the Commission has been working to foster RTOs for a number of years. So far, the Commission

has relied on the voluntary efforts of utilities to form RTOs, and has held mediation and outreach to assist market participants in reaching consensus on RTO governance, scope, and configuration. Nevertheless, to date not a single RTO is up and running.

I believe the price of doing nothing on RTO formation grows daily and that we must move forward. The Commission has recently initiated a number of processes to help ensure that any actions we take concerning the development of RTOs be ones that will produce the most benefits for customers and that adequately accommodate states' interests. First, the Commission recently hired an outside consultant to perform an updated study of the costs and benefits of RTO formation. Second, we have begun to consider the standard RTO design features that will best ensure a seamless national wholesale electricity market. During the week of October 15, 2001, we held a conference to discuss the issue of standard RTO design features with a wide range of market participants and state commissions, and we will be doing more outreach and issuing a proposed rule on the subject. Our RTO conference demonstrated considerable consensus on a number of issues, such as congestion management, energy markets, and market monitoring. Third, we have set up a new program within FERC under which a number of regional panels consisting of Commission staff and state commission staff will be established to ensure better coordination with our state regulatory counterparts on RTO development issues.

It may soon become necessary for the Commission to take more direct action to establish mandatory RTOs. I believe the current language of the Federal Power Act already gives us the authority to take such action, and I will encourage my colleagues to join me in exercising that authority in a prudent manner. Nevertheless, the few who oppose RTOs would likely file judicial challenges to the exercise of that authority, thus legislative clarification would save us all the time and expense of litigation.

B. Section 202 would not speed development of competitive markets

Section 202 of H.R. 3406 does clarify that the Commission has the authority to require transmitting utilities, whether investor- or publicly-owned, to join an RTO. However, the following provisions of Section 202 would leave the Commission so hamstrung in its exercise of this authority, that I fear we would make no greater progress toward the development of truly competitive wholesale electricity markets than we have under the current statute:

Narrowly prescribing Commission review of an RTO application—Section 202 limits the Commission's authority over the development of specific RTOs to proposing modifications to a utility's application to form or join an RTO. Further, the Commission can only propose such modifications when the application fails to satisfy a rigid and limited set of standards specified in the bill.

Allowing applicants to unnecessarily delay process—The provisions of Section 202 requiring the Commission to hold an "evidentiary" trial-type hearing on the proposed modifications whenever an applicant so requests and imposing a stay of the Commission's order whenever an applicant seeks judicial review could enable one RTO applicant to significantly delay and increase the cost of RTO formation.

Making it easier for applicants to overturn Commission orders—Section 202's replacement of the existing "substantial-evidence" standard for judicial review under the Federal Power Act with a "preponderance-of-the-evidence" standard for review of Commission modifications to RTO applications would make it easier for applicants to overturn such modifications.

C. Section 202 should be replaced with a simple affirmation of Commission authority to issue such RTO orders as are in the public interest

I believe that Section 202 may not achieve the goals that the Subcommittee has identified, *i.e.*, the creation of competitive markets. Therefore, I urge this Subcommittee either to replace it with a provision simply affirming the Commission's authority to issue such orders concerning the establishment, design, and operation of RTOs, and the participation of transmitting utilities therein, as are in the public interest. I would also urge the Subcommittee to consider tax code amendments to ensure that electric cooperatives and public power entities do not lose their tax-exempt status by transferring transmission assets over to a for-profit RTO.

III. SECTION 141-MERGER REVIEW

Section 141 would repeal Section 203 of the Federal Power Act and, thus, leave review of mergers and other dispositions of public utility facilities to the Department of Justice and the Federal Trade Commission. While I support coordination of federal agency review of proposed utility mergers to ensure that such reviews are

not duplicative or overly time-consuming, I do not believe it is appropriate to eliminate FERC review. The Commission has knowledge of the electric utility industry that the federal antitrust agencies do not, and Commission review is necessary to ensure that mergers and other dispositions are consistent with the public interest.

IV. OTHER PROVISIONS OF H.R. 3046

Although I would suggest changes to Sections 202 and 141, there are other provisions of H.R. 3046 that I heartily endorse.

A. Section 101 would ensure standardization of interconnection procedures and allow consideration of an application's effect on competition

Section 101 calls for standardization of interconnection procedures. I strongly support the development of standardized interconnection procedures, and I am happy to report that the Commission is conducting a rulemaking to address this issue.

I further support the proposed amendment of the criteria for evaluating an interconnection application. Under the existing language of section 210 of the Federal Power Act, the Commission may grant an application if it is in the public interest and it would either encourage overall conservation, optimize efficiency, or improve reliability. This bill would allow the Commission to grant an application if it were in the public interest and promoted competition. This language allows the Commission to continue to consider conservation, efficiency and reliability, while also permitting the Commission to consider competitive goals that will truly benefit consumers.

B. Section 102's net metering standards would remove a barrier to entry of new technology

I support the bill's call for minimum federal net metering standards. Most utilities have been slow to provide for net metering, and net metering is an essential step in the development of viable markets for new technologies, such as distributed generation. The establishment of national minimum standards on which states will build net metering programs would enable this important new technology a chance to compete. Net metering is also a valuable tool for consumers who want to be actively involved in their purchasing decisions.

C. Sections 111-125 would appropriately repeal PUHCA

I support the bill's repeal of PUHCA. PUHCA was necessary to address abuses that existed a half-century ago. However, that statute has not only outlived its usefulness, it is actually thwarting needed development of our electricity resources by subjecting registered utility holding companies to heavy-handed regulation of ordinary business activities and to outdated requirements that they operate "integrated" and contiguous systems. One of PUHCA's perverse effects is that it causes foreign companies to buy here and U.S. companies to invest overseas. Nevertheless, I appreciate the concerns of those, like the rural electric cooperatives, who have opposed elimination of certain safeguards that PUHCA provides against market power. The Commission is aware of the concerns of the cooperatives and of the problems with market power in general, and we are engaged in an overhaul of our efforts at market monitoring and market power protection. I believe that Section 111-125 strikes an appropriate balance by replacing PUHCA with increased access by the Commission and state regulators to certain books and records.

D. Sections 131-134 would appropriately eliminate prospective PURPA forced sales

I support the bill's prospective elimination of the forced sale provision of PURPA. PURPA was enacted out of concern over dependence on oil for electric generation. Now, 22 years later, when a gas-fired generator can be on-line in less than two years, and many advances are being made in distributed generation, PURPA's subsidies for certain types of generation are no longer appropriate.

E. Section 201 would ensure non-discriminatory access to the entire transmission grid

Section 201 would grant the Commission the authority to require all transmitting utilities (not just those that constitute "public utilities" under the Federal Power Act) to offer open access transmission service. I believe that all interstate transmission facilities should be under one set of open access rules, including the facilities owned and/or operated by municipals, cooperatives, the Tennessee Valley Authority, and the federal power market administrations and regardless of whether they are used for unbundled wholesale, unbundled retail, or bundled retail transactions. Having all transmission under one set of rules will ensure a properly functioning and transparent transmission grid.

F. Section 301 will promote transmission reliability

I support Section 301, which grants the Commission jurisdiction over electric reliability organizations. The reliability of the electrical grid is critical to this nation's safety and economy, and it is appropriate to have a greater governmental role in reviewing reliability standards.

G. Section 402 will remove logjams to siting needed transmission

As I stated in my September 21, 2001 testimony before this Subcommittee, I believe the Commission should have backstop authority to site transmission facilities. State-by-state siting of such transmission superhighways is an anachronism that impedes transmission investment and slows transmission construction. There are many models for regional planning that might be considered. For example, the Western Governors Association has been working hard to address regional issues in the West. Therefore, I support section 402, which allows the Commission to authorize construction of transmission facilities that are consistent with the public interest when the state has withheld or delayed approval. But I also believe new models may respond to siting issues in a way that recognizes state concerns while accepting the reality that electricity planning and operations are regional, if not national, in nature.

H. Sections 701-703 would provide needed expansion of enforcement authority

The Commission must have an expanded role in monitoring for, and mitigating, market power abuse. The enabling statutes of the Securities and Exchange Commission and the Federal Communications Commission provide for a range of enforcement measures, such as civil penalties. I believe that providing FERC with similar authority would send a powerful message to electricity market participants that we take violations of the Federal Power Act just as seriously. Therefore, I support H.R. 3406's recognition of the Commission's refund authority over non-public utilities that provide transmission service or power to a public utility. I also support the bill's increase in the level of criminal penalties allowed under Section 316 of the Federal Power Act, as well as the bill's authorization of civil penalties for violation of any provision of Part II of the Federal Power Act.

V. CONCLUSION

I appreciate the enormous commitment of time and energy that the Chairman and the other members of this Subcommittee have put into developing legislation to help transform the electricity industry into the thriving force it should be. There are many competing interests to be satisfied against a larger goal: the creation of a robust, viable, liquid energy market supported by an enhanced infrastructure. Our country is well served by change leaders such as yourself. I thank you for the opportunity to share my thoughts with you.

Mr. BARTON. We now welcome Commissioner Massey from the great State of Louisiana. He has obviously been here a few times. Your statement is in the record in its entirety. We would ask you to elaborate for 6 minutes. Arkansas, I am sorry, I said Louisiana—Arkansas.

STATEMENT OF HON. WILLIAM L. MASSEY

Mr. MASSEY. Thank you, Mr. Chairman. I respect and applaud your efforts to enact electricity restructuring legislation. My view is that without your help with changes in the law, the restructuring of the electric industry will continue to be a patchwork. Necessary transmission investments may not keep pace with the needs of competitive markets, and this is a very serious problem. And it will be much more difficult to maintain reliability long term.

Thus, a number of provisions of this legislation are excellent and have my support, and I have concerns about others. In particular, I support the provisions related to standardized generation interconnection, to ensure demand responsiveness, and those related to mandatory reliability rules, civil penalties and transmission infrastructure and siting. I particularly appreciate your interest, Chairman Barton, in solving this knotty problem related to transmission

siting, and it seems to me that you have proposed a manner of proceeding that balances competing concerns and is reasonable. I applaud it, and I think it will help get necessary transmission built.

These are all excellent provisions. I support placing all transmission under one set of Federal rules. I think we have to do this. The bill sends a strong signal that RTOs are in the public interest and that FERC may require their formation, and I applaud this.

The legislation also includes provisions that I cannot support, however. The Commission's merger review authority should not be repealed. Indeed, this authority should be strengthened to ensure that consumers are protected from consolidations that may choke off the very competition that we are striving to facilitate. And I would like to associate myself with the remarks of Commissioner Breathitt on this very point. In addition, I do not support legislatively tying FERC's hands with respect to RTO approval standards and hearing procedures. These should remain a matter of Commission policy that may evolve over time with the changing needs of competitive markets.

Let me close by saying, since members of the subcommittee have raised the Enron collapse, I am deeply concerned about the Enron collapse. I am concerned about the 21,000 employees who are losing their jobs, I am concerned about investors and retirees who lost their shirts, I am concerned because Enron was the most visible corporate symbol of energy deregulation in the world. We should be looking at whether there are lessons here for our evolving energy policy.

Based upon what I have seen thus far, however, the collapse was not related to a failure in energy markets. In fact, a strong argument can be made that if Enron had focused on energy assets and energy trading in the United States and had it accurately disclosed profits and losses, it would probably still be humming right along. And the energy market appeared to recover rather quickly from the Enron collapse. We don't know the whole story yet, but what we know thus far indicates that the market has adjusted reasonably. Other market participants moved into the breach. The energy market itself did not collapse.

Nevertheless, whatever lessons there are here for energy policy and energy markets, we should heed those lessons. Perhaps the accounting standards and disclosure requirements for a public utility should be a strengthened—perhaps we should take a look at disclosure requirements for all public utilities. I have an open mind. But the good news here is that the short-term energy markets appeared to adjust rather quickly to the collapse of the largest energy trading company in the world. Thank you, Mr. Chairman.

[The prepared statement of Hon. William L. Massey follows:]

PREPARED STATEMENT OF HON. WILLIAM L. MASSEY, COMMISSIONER, FEDERAL ENERGY REGULATORY COMMISSION

Mr. Chairman and Members of the Subcommittee on Energy and Air Quality: Thank you for the opportunity to testify on the important electricity legislation now pending before the House and recent Commission activity promoting efficient and reliable electricity markets.

I. H.R. 3406—THE ELECTRIC SUPPLY AND TRANSMISSION ACT

A. Interconnection

I am generally supportive of the provisions of Title I. Section 101 addresses interconnection standards. The Commission has made a firm decision to move forward on developing standard procedures and agreements regarding interconnection and will likely do so in a way that is consistent with section 101.

B. Demand response

Section 103 provides for implementation of price responsive demand programs. As I have testified previously, markets need demand responsiveness to price. This is a standard means of moderating prices in well-functioning markets, but it is generally absent from electricity markets. When prices for other commodities get high, consumers can usually respond by buying less, thereby acting as a brake on price run-ups. If the price, say, for a head of cabbage spikes to $50, consumers simply do not purchase it. Without the ability of end use consumers to respond to price, there is virtually no limit on the price suppliers can fetch in shortage conditions. Consumers see the exorbitant bill only after the fact. This does not make for a well functioning market.

Instilling demand responsiveness into electricity markets requires two conditions: first, significant numbers of customers must be able to see prices *before* they consume, and second, they must have reasonable means to adjust consumption in response to those prices. Accomplishing both of these on a widespread scale will require technical innovation. A modest demand response, however, can make a significant difference in moderating price where the supply curve is steep.

Once there is a significant degree of demand responsiveness in a market, demand should be allowed to bid demand reductions, or so called "negawatts," into organized markets along with the megawatts of the traditional suppliers. This direct bidding would be the most efficient way to include the demand side in the market. But however it is accomplished, the important point is that market design simply cannot ignore the demand half of the market without suffering painful consequences, especially during shortage periods. There was virtually no demand responsiveness in the California market. Customers had no effective means to reduce demand when prices soared.

It is important for Congress to send a message that instilling a significant measure of demand responsiveness into electricity markets is in the public interest. This legislation does just that, and I endorse it.

C. PUHCA and PURPA

Subtitle B of Title I repeals PUHCA. I am pleased that the bill appears to include important provisions regarding state and federal access to the books and records of holding companies and their subsidiaries.

Subtitle C of Title I repeals PURPA on a going forward basis. I would support such repeal of PURPA if there were a mechanism to promote the development of renewable resources, such as a reasonable portfolio standard.

D. Review of Mergers

Section 141 repeals the Commission's authority to review mergers. I do not support this provision. As we strive to move toward competitive markets and light-handed regulation, the Commission's ability to remedy market power is increasingly important. Market power is likely to exist in the electric industry for a while. It is unreasonable to expect an industry that has operated under a heavily regulated monopoly structure for 100 years suddenly to shed all pockets of market power. An agency such as FERC with a broad interstate view must have adequate authority to ensure that market power does not squelch the very competition we are attempting to facilitate.

The Commission's authority over mergers is important. We are seeing unprecedented industry consolidation now. While mergers can produce efficiencies, they can also increase both horizontal and vertical market power. The Commission is particularly well suited to evaluate proposed mergers involving electric utilities. The Commission's detailed experience with electricity markets and its unique technical expertise can provide critical insights into a merger's competitive effects. In addition, the Commission's duty to protect the public interest is broader than the focus of the antitrust agencies and thus allows us to better protect consumers from other possible effects of a merger, such as unreasonable costs. As the architect of Order No. 888 and the RTO Rule, Order No. 2000, the Commission must retain the authority to condition a merger to ensure consistency with broader policy goals. And unlike the antitrust agencies, the Commission's merger procedures allow public interven-

tion and participation in proceedings critical to the restructuring of this vital national industry.

For these reasons, I would not support any weakening of the Commission's merger authority. Indeed, to ensure that mergers do not undercut our competitive goals, the Commission's authority over electricity mergers must be strengthened in a number of ways. The Commission should be given direct authority to review mergers that involve generation facilities. The Commission has interpreted the Federal Power Act as excluding generation facilities *per se* from our direct authority, although that interpretation is currently before the courts. It is important that all significant consolidations in electricity markets be subject to Commission review. For the same reason, the Commission should be given direct authority to review consolidations involving holding companies.

I am also concerned that significant vertical mergers can be outside of our merger review authority. Under section 203 of the FPA, our merger jurisdiction is triggered if there is a change in control of jurisdictional assets, such as transmission facilities. Consequently, consolidations can lie outside of the Commission's jurisdiction depending on the way they are structured. For example, a merger of a large fuel supplier and a public utility would not be subject to Commission review if the utility acquires the fuel supplier because there would be no change in control of the jurisdictional assets of the utility. If the merger transaction were structured the other way, i.e., the fuel supplier acquiring the utility, it would be subject to Commission review. Such vertical consolidations can have significant anticompetitive effects on electricity markets. Those potential adverse effects do not depend on how merger transactions are structured, and thus our jurisdiction should not depend on how transactions are structured. Therefore, I recommend that the Commission be given authority to review all consolidations involving electricity market participants, however structured.

E. Open Transmission Access

Section 201 allows the Commission to require all transmitting utilities as well as public utilities to offer open access transmission service. I am generally supportive of placing all transmission owners under the same set of rules. I have concerns, however, with codifying the manner in which the Commission should calculate stranded costs. Such calculation should be left to the Commission's discretion and judgment.

F. Regional Transmission Organizations

Section 202 sets out a number of provisions regarding RTOs and RTO formation. I am particularly pleased that this legislation sends a clear message that RTOs are in the public interest. Nevertheless, I am concerned with the proposals to codify matters such as RTO standards, hearing requirements, and when the Commission may or may not make modifications to existing RTOs. It would be far more useful to give the Commission express authority to require RTO formation under standards determined to be appropriate by the Commission. This would allow standards to evolve along with the requirements of competitive markets.

G. Reliability

Section 301 provides for Commission certification of an organization to develop and enforce reliability standards. The industry needs mandatory reliability standards. Vibrant markets must be based upon a reliable trading platform. Yet, under existing law there are no legally enforceable reliability standards. Compliance with the reliability rules of the North American Electric Reliability Council (NERC) is voluntary. A voluntary system is likely to break down in a competitive electricity industry.

I support legislation that would lead to the promulgation of mandatory reliability standards. A private standards organization with an independent board of directors could promulgate mandatory reliability standards applicable to all market participants. These rules would be reviewed by the Commission to ensure that they are fair and not unduly discriminatory. The mandatory rules would then be applied by RTOs, the entities that will be responsible for maintaining short-term reliability in the marketplace. Mandatory reliability rules are critical to evolving competitive markets, and I urge Congress to enact legislation to accomplish this objective.

Section 301 seems reasonable and I support its adoption.

H. Transmission Infrastructure

Section 401 directs the Commission to adopt policies that facilitate construction of transmission facilities needed for competitive electricity markets, and to report to the Congress on transmission adequacy. I support these goals. I am particularly supportive of the legislation's specific goals such as promoting economically efficient

enlargement of transmission networks, including the provision of proper price signals so that new generation and transmission is built where it provides the lowest overall cost to consumers.

I. Transmission Siting

Section 402 enacts backstop transmission siting authority for the Commission. In previous testimony, I have recommended that Congress transfer to the Commission the authority to site new interstate electric transmission facilities. The transmission grid is the critical superhighway for electricity commerce, but it is becoming congested because of the new uses for which it was not designed. Transmission expansion has not kept pace with changes in the interstate electricity marketplace.

Although the Commission is responsible for well functioning electricity markets, it has no authority to site the electric transmission facilities that are necessary for such markets to thrive and produce consumer benefits. Existing law leaves siting to state authorities. This contrasts sharply with section 7 of the Natural Gas Act, which authorizes the Commission to site and grant eminent domain for the construction of interstate gas pipeline facilities. Exercising that authority, the Commission balances local concerns with the need for new pipeline capacity to support evolving markets. We have certificated well over 15,000 miles of new pipeline capacity during the last six years. No comparable expansion of the electric grid has occurred.

I continue to recommend legislation that would transfer siting authority to the Commission. Such authority would make it more likely that transmission facilities necessary to reliably support emerging regional interstate markets would be sited and constructed. A strong argument can be made that the certification of facilities necessary for interstate commerce to thrive should be carried out by a federal agency.

Adequate grid facilities are essential to robust wholesale power markets. I am confident that transmission will be built in sufficient quantities if siting authority is rationalized, rate jurisdiction is clarified, and adequate cost recovery mechanisms and risk-based rates of return are allowed.

Proposed section 402 provides the Commission with backstop siting authority to ensure that the necessary transmission facilities are built. This provision appears to provide appropriate respect for the siting prerogatives of the states and has my support.

J. Federal Utilities

I have long advocated placing all transmission providers under the same set of rules. Placing TVA, BPA and the Federal Power Marketing Administration under Commission authority has my full support.

Section 523 permits BPA to transfer operational control of its transmission facilities to an RTO. Although I strongly support allowing BPA to participate in an RTO, I would not limit its participation in an RTO of a specific scope as this section does. In addition, I would recommend that Congress specifically authorize TVA and the PMAs to participate in RTOs determined to be appropriate by the Commission.

K. Penalties

Section 703 expands the scope of civil penalties to include all of Part II of the Federal Power Act. This provision moves toward giving the Commission much needed tools to police the markets and I support it.

II. RECENT FERC ACTION ON RTO FORMATION AND MARKETS

A. RTO Formation

The Commission has received a number of proposals to form RTOs, and has acted on most such proposals. In general, the Commission has strongly encouraged RTOs to grow larger and has provided guidance on independence and RTO governance. In July, the Commission issued an order expressing its preference for no more than four large RTOs in the nation, but has recently indicated that greater flexibility will be allowed in RTO formation.

During October 15-19, 2001 the Commission held five days of public hearings on a wide range of issues related to RTO formation and market design. In an order issued November 7, the Commission indicated a desire to receive additional comment from state commissions with regard to RTO formation, and indicated that additional cost benefit analyses on RTOs would be conducted. Also, the Commission stated its intention to standardize market design rules as appropriate. The November 7 order stated that since it is not possible for all RTOs to be in operation by our December 15, 2001 deadline, the Commission will set out in future orders a time

line for continuing RTO progress in each region. I expect the Commission to act on such orders in the near future.

B. Market-based Rates

In two orders the Commission issued November 7, 2001, we began to correct severe weaknesses in our market based pricing policy. My longstanding concerns had been sharpened by the failure of the California market and the economic consequences that spun from it. We've learned that we must accurately assess market conditions when depending on markets to discipline prices. And we must provide adequate refund protection to customers when poorly functioning markets do not protect them from unreasonable prices.

In AEP Power Marketing, *et al.*, the Commission took three important steps in our market based pricing policy. First, we concluded that our traditional market power analysis no longer adequately protects customers against generation market power.

Second, we announced a new interim analytic screen to protect customers until we develop the tools we need for the longer term. That interim tool is the Supply Margin Assessment, or SMA, and will be applied to all sales except those into an ISO or RTO with approved monitoring and mitigation. This is a major step in the right direction. The SMA improves on the old analysis by taking into account transmission capability and by looking to the critical notion of a "pivotal supplier" in a market. When supplies are tight, prices in electricity markets can run up quickly, especially when there is a pivotal supplier whose capacity is needed to satisfy demand. The SMA addresses that problem and does not allow pivotal suppliers to charge market based prices. The SMA is a major improvement. Like most new policy tools, it is not perfect, but we are moving in the right direction. As with any analytic method, it is only a snapshot of current market conditions. But if market conditions change, parties are free to file a complaint showing that the new conditions result in a seller failing the SMA screen.

Third, the Commission applied the SMA to three sellers in the context of their triennial updated analysis, found that they fail, and put in place innovative mitigation measures requiring the applicants to offer all uncommitted generation capacity into the spot market. Sales will be priced at the traditional split savings adder. As the order points out, maintaining an accurately priced spot market is the single most important element for disciplining longer term transactions. Thus, with the spot market mitigation in place, an applicant may freely negotiate longer term transactions but must post on its web site a portfolio of long term products and prices that are available.

In another order issued November 20 in EL01-118, the Commission took two additional important steps. First, we announced the start of a generic proceeding to develop new analytic methods for evaluating markets and market power on a long term basis. I fully support launching this important initiative. Second, the order initiated a section 206 proceeding to place a refund condition in the tariffs of sellers with market based pricing. That condition would prohibit anticompetitive behavior and the exercise of market power. This is an improvement providing customers with some added protection, and to that extent I support the order.

But we should do more for customers. The order fails to provide any refund protection to customers when market structure and market rules are flawed and unjust and unreasonable rates result. The Federal Power Act states that such rates are unlawful. This is precisely the situation in which the Commission found itself in the California proceeding. We did not make any findings of bad behavior on the part of any sellers. We found only a market that was badly broken. The risk of a broken market should not be placed solely on customers. Our tariff condition should provide for refunds whenever the Commission finds that unjust and unreasonable rates are charged.

III. CONCLUSION

I stand ready to answer questions and to assist the Subcommittee in any way. Thank you for this opportunity to testify.

Mr. BARTON. Thank you, Commissioner.

We would now like to hear from the chairman of the Tennessee Valley Authority. I believe this is your first time to testify.

STATEMENT OF GLENN L. MCCULLOUGH, JR.

Mr. MCCULLOUGH. Before your subcommittee, it is, sir.

Mr. BARTON. Yes, sir.

Mr. MCCULLOUGH. Thank you, Mr. Chairman.

Mr. BARTON. Your statement is in the record, and you are recognized for 6 minutes.

Mr. MCCULLOUGH. Thank you very much, Mr. Chairman and distinguished members of the subcommittee. I would like to thank you, Chairman Barton, as well as Ranking Member Boucher, for your leadership on issues relating to the supply of reliable and affordable electricity throughout the Nation. I would also like to express my gratitude and appreciation to Congressman Ed Bryant, Congressman Chip Pickering, Congressman Bart Gordon and Congressman Ed Whitfield, all of whom sit on this subcommittee as they have been amongst the strongest advocates for the people of the Tennessee Valley and TVA.

We are very grateful to them for their collective support of the TVA title. The title represents their consensus, and ours, on the best way to comprehensively address TVA's place in a more competitive market. I would also like to thank the Tennessee Valley Public Power Association, the Tennessee Valley Industrial Committee for their help in drafting this important legislative proposal. The title, which is now part of H.R. 3406, affirms TVA's role as a steward within the Valley region, and it maintains the integrity of TVA's mission. It ensures the availability of affordable electricity for rural and fixed-income consumers in the Tennessee Valley, and it ensures the reliability of TVA's power supply and transmission system.

The specific provisions of the title are discussed in my written testimony, and TVA and its customers believe that these provisions are in the best interest of the people and the businesses of our region. We are grateful to everyone who had a role in developing the TVA title, and we appreciate the support it has received from members of the subcommittee.

It has been more than 2 years since a representative from TVA appeared before this subcommittee, Mr. Chairman. In that time there have been many changes, and truly it is a new day at TVA. Director Skila Harris and I began serving the Valley in November 1999. Director Bill Baxter was sworn in less than 2 weeks ago. We are committed to making TVA a more responsible and business-like agency as we work to deliver affordable, reliable power, a cleaner environment and a vibrant economy for the good of the people.

I would like to report to the subcommittee that TVA is stronger operationally and financially as our entire organization prepares for the future of competition. And I am proud to say that through our diverse power supply, reliable transmission system, operational and financial performance and leadership in renewable energy and new technologies, TVA is addressing some of the key concerns in our Nation's energy future. While there is still much work to be done, I am confident that TVA will add value in the competitive marketplace as a result of our excellent business performance.

Now let me take just a couple of moments to share some of the recent examples of the value we provide to the people in the Tennessee Valley. Through distributors of TVA power, we provide affordable, reliable electricity to 8.3 million residential consumers. And in recent years, we have pushed TVA's performance to new

levels of excellence. TVA won the 2001 Quality Cup awarded by the Rochester Institute of Technology in USA Today for comprehensive business improvement initiatives. During fiscal year 2001, our customer outage duration was three times better than the average of other U.S. companies we benchmark. In 2000, TVA's Sequoyah and Browns Ferry Nuclear Plants were ranked as the second and third most efficient nuclear power generators in the Nation.

TVA is providing financial value to our customers, having had only one rate increase in 14 years. We reduced TVA's debt by $610 million in fiscal year 2001, which is $160 million more than was projected. We reduced TVA's overall interest expense as a percentage of revenue to its lowest level in more than 15 years. We are repaying the U.S. Treasury for its original investment in the TVA power system. For fiscal year 2001, our payment to the Treasury, including principal and interest, was $55 million. TVA does not receive any Federal appropriations.

TVA's commitment to excellence also provides value for the environment. TVA has conducted a multibillion dollar program to further reduce nitrogen oxide and sulfur dioxide emissions from our generating plants. By 2005, we will have reduced sulfur dioxide emissions 75 to 80 percent since 1977. Nitrogen oxide emissions during the ozone season will be down by 70 to 75 percent. In addition, TVA is one of the first three utilities in the Nation to offer an accredited green power option for our customers.

In these and many other ways, TVA provides value to our customers and value to the Nation. Our priorities are closely aligned with the issues identified in the national energy policy. By providing reliable, affordable, environmentally sound energy, TVA is demonstrating many of the objectives outlined in this policy. I will work very closely with you, with every member of this subcommittee as we continue to work on ways to improve affordable, reliable energy for the Nation.

Thank you for this opportunity to appear before you today, and I look forward to answering any questions.

[The prepared statement of Glenn L. McCullough follows:]

PREPARED STATEMENT OF GLENN L. MCCULLOUGH, JR., CHAIRMAN, TENNESSEE VALLEY AUTHORITY

Good afternoon, Mr. Chairman and distinguished members of the Subcommittee. I would like to thank you, Chairman Barton, as well as Ranking Member Boucher, for your interest and leadership on issues relating to the continuous supply of reliable and affordable electricity throughout the Nation. I assure you that it is an issue we take very seriously at the Tennessee Valley Authority.

I am pleased to be here today to discuss with the subcommittee how H.R. 3406, the *Electric Supply and Transmission Act*, addresses the way in which TVA might look in the more competitive and restructured electricity marketplace of the future. Together with the Tennessee Valley Public Power Association (TVPPA), the trade association representing the distributors of TVA power, and the Tennessee Valley Industrial Committee (TVIC), which represents TVA's large industrial customers, I am very pleased that the Valley's consensus language was accepted as the TVA title in H.R. 3406. Additionally, this language is generally acceptable to the administration. The regional consensus approach, included in this title, reflects a great deal of hard work and compromise from stakeholders throughout the Valley, and represents a common-sense approach to addressing, in a comprehensive manner, the unique setting of TVA in the electricity marketplace. It is for this reason that I would like to express a great deal of gratitude and appreciation to Congressman Ed Bryant, Congressman Chip Pickering, Congressman Bart Gordon, Congressman Rick Boucher, and Congressman Ed Whitfield, all of whom sit on this subcommittee,

as they have all been among the strongest advocates for TVA, TVPPA, TVIC, and most importantly the Valley's ratepayers, throughout this process.

A NEW DAY AT TVA

It has been more than two years since a representative from TVA last appeared before this subcommittee. In that time, there have been many changes, and it is a new day at TVA. We have a completely new Board. Director Skila Harris and I began serving the Valley in November of 1999 and Director Bill Baxter was sworn in less than two weeks ago. We are committed to making TVA a more responsible and business-like agency as we work to deliver affordable, reliable power, a cleaner environment and a vibrant economy for the good of the people.

I would like to report to the subcommittee that TVA is stronger operationally and fiscally as the entire organization prepares for the future of competition. While there is still much work to be done, I am confident that a very bright future lies ahead for the people we are charged to serve. As a result of our hard work, I am certain that we will succeed in the competitive marketplace as people continue to recognize the value TVA delivers through excellent business performance.

TVA BACKGROUND

TVA, which is the Nation's largest provider of public power, was created by Congress in 1933 to provide for flood control, navigation, and the generation of electric power in the seven-state region of the Tennessee Valley, which includes Alabama, Georgia, Kentucky, Mississippi, North Carolina, Tennessee, and Virginia. This mission is the cornerstone of our service across the Valley today. Together with 158 municipally and cooperatively owned distributor customers, TVA provides electricity ultimately to 8.3 million residential consumers throughout the Tennessee Valley, while managing and developing the Tennessee River watershed and providing leadership for sustainable economic development for the people we serve.

The Tennessee River system is the fifth-largest river basin in the United States. It stretches 652 miles from Knoxville, Tennessee, to Paducah, Kentucky, where it flows into the Ohio River and ultimately the Mississippi. It encompasses over 11,000 miles of shoreline, 54 dams and 14 locks. About 34,000 loaded barges travel the Tennessee River each year—the equivalent of two million trucks traveling the roads. TVA, incidentally, no longer receives any federally appropriated funds for the management and stewardship of the Tennessee River. TVA has used power revenues for these functions since October 1999.

TVA's power system has a generating capacity of 30,365 MW. TVA operates 59 coal fired units at 11 plants, five nuclear reactors at three plant sites, 29 hydropower plants, and five combustion turbine plants. The Bush Administration's National Energy Policy released earlier this year recognizes the importance of diversity in energy supply—including new attention to promoting nuclear energy, clean coal technologies, and renewable energy sources. TVA's mix of coal, nuclear, hydroelectric, and natural gas-fired generation resources illustrates the value and benefits of such diversity. In FY2001 TVA's generation sources were approximately 65 percent fossil and combustion turbine, 29 percent nuclear, and 6 percent hydropower.

TVA provides wholesale power to 158 local power distributors and 62 directly served customers through a network of 17,000 miles of transmission lines in the seven state region. The TVA Act directs the three members of the Board of Directors, all of whom are appointed by the President and confirmed in the Senate, to set TVA's electric rates as low as feasible, while recovering the full costs of providing electricity for the Valley.

TVA'S BUSINESS PERFORMANCE

I am very proud of the way employees from throughout TVA have responded to the call of service in the public interest throughout the Tennessee Valley. Here are just a few examples of our most recent accomplishments:

POWER SYSTEM

- In Fiscal Year 2001, TVA transmission reliability to customers was 99.999 percent. To put that In perspective, we are three times better in terms of customer outage duration than the average of the U.S. companies we benchmark.
- TVA won the 2001 Quality Cup awarded by the Rochester Institute of Technology and *USA Today* for a comprehensive improvement initiative. The improvements helped TVA set a best-in-industry record for transmission system operating efficiency.

- The July 2001 issue of *Nucleonics Week* ranked TVA's Sequoyah and Browns Ferry nuclear plants as the second and third most efficient nuclear power generators in the Nation in 2000.
- On October 15, 2001, TVA broke ground on the nation's first large-scale flow-battery energy-storage plant. The Regenesys plant, located in Mississippi, will store electricity during off-peak periods and release it for use when the need for electricity increases, using a chemical process to store energy.

FINANCIAL

- Fiscal Year 2001 power sales increased by 1.2 percent over sales the previous year and interest expense was down $103 million from the 2000 fiscal year.
- TVA reduced debt by $610 million in 2001, $160 million more than projected, for a total reduction of almost $2.4 billion since 1997. Interest expense in 2001 accounted for 23 percent of TVA revenue, down from a high of 34 percent in 1997, for the lowest percentage in more than 15 years. TVA continues to be interested in further cost cutting and debt reduction where warranted.
- Fiscal year 2002 budget projections estimate revenues exceeding $7—billion for the first time in TVA's history.
- In the fiscal year 2001, TVA sent $55 million to the United States Treasury, $20 million in principle and $35 million in interest, on the original appropriated investment in TVA. To date, TVA has returned to the Treasury $3.4 billion, including interest, on the original investment of $1.419 billion.

ENVIRONMENTAL STEWARDSHIP

- On October 4, 2001, TVA announced plans to construct five scrubbers, one each at fossil plants in Kentucky and Alabama, and three at two plants in Tennessee. They will cost about $1.5 billion altogether and when completed will collectively reduce emissions of sulfur dioxide by more than 200,000 tons per year. At that point TVA will have reduced total SO2 emissions by 85 percent since 1977.
- TVA is also in the midst of a $1 billion program to reduce nitrogen-oxide emissions at its plants by constructing 18 selective-catalytic-reduction systems—or SCRs—on 25 coal-fired generating units. It is one of the most massive pollution-control programs in the nation. This will reduce TVA's NO_X emissions by 70 to 75 percent during the ozone season by 2005.
- TVA is one of only three utilities in the nation to offer a fully accredited Green Power option to its customers. Along with participating distributors, TVA offers residential consumers 150 kilowatt-hour blocks of electricity that include a portfolio of wind, solar, and land-fill gas generation.
- TVA's power system is setting production records, operating more efficiently and more cost-effectively than at any time in the past three decades, and TVA has had only one rate increase in 14 years. Affordable, reliable electric power is the fuel of our region's economy, and TVA is performing as a business as it delivers power production, economic growth and environmental stewardship for the region.

THE TVA TITLE

Once again, I would like to express my appreciation for the subcommittee's leadership on electricity issues and to you specifically, Chairman Barton, for working closely with members from the Tennessee Valley delegation on issues relating to TVA. As a Federal corporation, TVA plays a unique role in meeting the power supply needs of the seven-state Tennessee Valley region, and there are statutory and regulatory issues that affect our region that are not experienced by investor-owned utilities. As a result, TVA has been involved in extensive discussions with distributors of TVA power and industries directly served by TVA in an effort to reach consensus on the appropriate role for TVA to play in a future restructured competitive environment. The TVA provisions that are part of H.R. 3406 reflect that consensus, although they are still under review within the Administration. Some of the key provisions within the TVA title in H.R. 3406 include:

Equitable Competition

- Restrictions to fair competition, such as the TVA "Fence" and "Anti-Cherry Picking" amendment will be removed simultaneously on the effective date of federal legislation.

TVA Power Sales

- TVA will only sell electricity outside of the existing service area at the wholesale level. These sales will be limited to electricity that is excess to the demand of its customers in the TVA service area.
- TVA will be permitted to sell to its existing retail customers inside the TVA service area. Only if retail open access is implemented in a distributor's service area will TVA be allowed to sell to new retail customers in that distributor's service area.

Regulation of TVA Transmission System

- TVA transmission service rates, terms and conditions will be subject to regulation by the Federal Energy Regulatory Commission.

It would come as no surprise to any of you that TVA is a large and complex organization and quite different from any other utility in the Nation. The area in which TVA can serve electricity is limited by law. The boundary that was established by the 1959 amendments to the TVA Act is known as the "fence." While TVA is limited outside the fence, other utilities are limited in their ability to serve loads within the fence. Many of these unique and complex issues may require Congressional action.

TVA's mission, as codified by the TVA Act, is to serve the people of the Valley. There is a key theme throughout the TVA title contained in H.R. 3406 that I would like to emphasize—the title continually reaffirms TVA's role as a steward *within* the Valley region. The original mission is left unchanged by the title I have come here to discuss today.

In the effort to maintain the integrity of our original mission, TVA has agreed to several restrictions that I am certain no other utility in the country would be willing to subject themselves to. The TVA Title in H.R. 3406, creates a model where TVA would be required to renegotiate its current contracts with all of its customers inside the Valley in order to bring about wholesale competition. Furthermore, with respect to sales outside the Valley, this title prohibits TVA from selling to any retail customers outside the Valley, and allows only the sale of excess power to wholesale customers outside the Valley.

TVA has been in the process of preparing for competition for several years. As I mentioned earlier, we have reduced debt by $2.4 billion over the past four years, while reducing the interest burden of our debt from a high of 34 percent of our costs in 1997 to the current rate of 23 percent. Additionally, we have been paying debt down while making significant upgrades to our transmission system to ensure reliability, adding peaking generation to our system, and installing significant emissions control equipment at our fossil plants across the Valley. All of these things add up to better service to our customers. We continue to believe that when competition arrives in the Valley, we will be the low-cost choice for our customers.

Customer service has been a core component of the process of developing the consensus title. To this end, in addition to internal preparation for competition, we are also in the midst of discussions with our customers about the future. We have offered distributors of TVA power a 10-percent partial-requirements contract and a shorter-term contract. In doing so, we hope to promote a new relationship with our customers through innovation and flexibility. Moreover, while some distributors are seeking shorter-term contracts, others would like long-term contracts with more price stability and rate security. The needs of our customers are diverse. By working closely with distributors and knowing what each distributor plans for its future, TVA can best serve the Valley in the competitive future.

I would like to share several basic principles that we believe are necessary, with respect to the TVA Title, as this subcommittee moves forward: (1) that TVA legislation affirms TVA's responsibility for the integrated resource management of the Tennessee River and economic development; (2) ensures the availability of affordable electricity for rural and fixed-income consumers in the Tennessee Valley; and (3) ensures the continued reliability of the power supply and the transmission system.

CONCLUSION

TVA is working hard to prepare for competition by reducing our debt, keeping our electric rates low, and efficiently managing the Tennessee Valley's integrated resource system. I want to assure all of you that TVA will continue to work cooperatively with Congress and the people of the Valley to ensure that restructuring is done in a way that's fair to TVA, to the ratepayers, to our distributors, to taxpayers, and that it enables us to set the standard for public power in the future.

We have worked with many stakeholders, especially TVPPA and TVIC, to develop a regional, common sense approach to restructuring. I am very proud of the progress

we have made at TVA, and I have never been more confident that the Valley's future is bright. I hope to continue working very closely with this Subcommittee, and I applaud you all for your insight and leadership. Furthermore, TVA and the Administration look forward to working with Congress on the legislative provisions in Title V dealing with TVA. Thank you again for the opportunity to appear here today, and I look forward to answering your questions.

Mr. BARTON. Thank you, Mr. Chairman. The Chair recognizes himself for 5 minutes for questions.

There is never going to be a good time to comprehensively try to change an industry that is as integral to our Nation's economy as the electricity generation, transmission and distribution industry, because there are always going to be vested players with status quo special interests that they wish to protect. So there comes a time you have to hold a number of hearings, and then you have to look at all the record and put your best team on the field, so to speak. And that is what the latest bill is, H.R. 3406.

Let me say with regard to Enron in that the bill that the subcommittee passed last year Enron opposed. The only CEO I have ever thrown out of my office was the CEO of Enron, Mr. Jeff Skilling, because he came into my office last year and basically told me what was going to be in the bill or else, and I said, "or else," and he was asked to leave. Now, we later had some substantive discussions, but if anybody thinks that Enron can dictate what this subcommittee does or what this subcommittee chairman does, I have got a bridge in Brooklyn that I want to try to sell you, because that just does not happen.

And I can also say with regards to what happened at Enron that it is amazing to me that the largest player in making the market, Enron Online was the largest market maker for wholesale electricity, and I think I am correct in saying for natural gas too, although I may be incorrect in that, that it was larger by orders of multiples. The day after Enron Online went blank there was no energy price spike, there were no shortages of electricity or natural gas anywhere in this country.

And if you think about that, if you were in a town that had two grocery stores, or maybe three grocery stores, and one was a little Mom and Pop on the corner, and the other one was one that had just come into town, and the other one was one that dominated the market and had 70 percent of the market, and that grocery store shut down. People would probably not have food the next day in certain parts of that community. That did not happen when Enron went belly up. The market worked. Power was presented and the prices didn't spike and life went on.

So I don't think that this is a hearing necessarily going to be dominated by what happened at Enron. Enron leveraged itself to the hilt and engaged in some accounting practices that were very questionable, to say the least. And we have investigators looking at those, as does the Financial Services Committee. So if there are corrections to be made because of what happened at Enron, so be it, but that does not take away the need to create a national electricity system that is based on open markets that are accessible to all.

Now let me ask a few questions to our distinguished panel. Does everybody on the panel support the position in the bill that everybody, whether they are an IOU, a muni or a co-op, if they are en-

gaged in the interstate transmission, has to be a part of an RTO? Is there anybody that opposes that? Okay. Nobody is saying anything, so the Chair is going to say they are all looking at me like they at least accept it if not support it.

Mr. MCCULLOUGH. Mr. Chairman, TVA believes that the concept of a Regional Transmission Organization in the Southeast is desirable, and we pledge to work cooperatively with this subcommittee toward that concept in a way that is fair to our ratepayers, our distributors and our bond holders.

Mr. BARTON. Well, the bill does make all Federal power administrations, including Bonneville and TVA, FERC jurisdictional for interstate transmission rates.

To my four commissioners, the pending bill requires that RTOs be up and functional 1 year after date of enactment. I am told that the pending proposals—and I don't want you to comment necessarily on any specific proposal—but that the proposals on RTOs that are currently before the FERC those are in sufficient shape that within a year after passage of this bill, if we maintain the current language, we could have RTOs up and functioning. Do you all agree or disagree with that?

Mr. WOOD. Chairman Barton, I would agree with that.

Mr. BARTON. You would agree. And the other FERC commissioners all agree with that.

We have a title in this on reliability, which several of the commissioners, I believe, in your written—and I know the Deputy Secretary of Energy, in his statement, said is an improvement over the past bill. Would the FERC commissioners wish to comment on the reliability title of the bill?

Mr. MASSEY. I think it is a good title, Mr. Chairman. I think you ought to enact it.

Mr. BARTON. Oh, well, I appreciate that.

Ms. BREATHITT. I support it and said so in my testimony and didn't have any recommended tweaks or changes.

Mr. BARTON. Okay. I have got 12 seconds left; I want to ask some questions later in the hearing, if we have time, about the FERC order on market power and the ability to set market prices. I have had a phone conversation with Chairman Wood about this. I read, I believe, the dissenting opinion that Commissioner Breathitt had when that order came out. I share some of Commissioner Breathitt's concerns about it. It would seem to me that we would not want to penalize a market maker or a market provider before there has even been a complaint of market power.

And as I understand the order, just the fact that you have enough reserve capacity so that if your reserve capacity is larger than the peak power demand, you are deemed automatically to have market power and to have used that market power. And to me that is a little bit like being convicted before there has even been a crime committed. So I have got some concerns about that. I would let Chairman Wood comment briefly, and then I am going to have to go to Mr. Boucher, because my time has expired.

Mr. WOOD. Thank you, Chairman Barton. The supply margin assessment test that we adopted following discussions we had since the first day I was on the Commission, I think all four of us and our prior colleague, Curt Hébert, recognize that the tests that we

were applying to market-based rate authority, which is in effect a deregulation certificate, in light of the California history and the need for the Commission to do what I would characterize as a pretty dramatic response to that, is to make sure that this never happens again.

There is a balance between having a totally deregulated market, which is what we had in the West, and the need to do what we had to do on June the 19th, which was put a mitigation plan over the top of every single player in the entire western half of the country. We were looking for something, or I was, certainly, looking for something much more surgical than that, that would not be an after-the-fact response but would in effect look at who has the ability to exercise market power, allow them to make the money and to make, in the formula that we adopted, sufficient money, but not allow them to go above a cloud of reasonable rates, which we are required under the Federal Power Act to maintain a zone of reasonableness for rates in advance.

It is not a conviction of something, they are not being punished for something, but we identify people who because of their size in a relevant market have the ability to actually control the price of that market and say you can do so much but not more than that. It is to me an example of what I would hope any Federal agency would do: get through the crisis and then look at what could in fact be a more focused and surgical solution toward making sure that crisis never happens in any other part of the country again.

So with the 1,200 people who have deregulation certificates, there may be a few, as they come back through the Commission, that because of their size are going to be subject to the supply margin assessment test. But I think that is a pragmatic response to a situation that we want to ensure never happens again, because customers do not need to go through what they went through in the West again.

Mr. BARTON. Well, put me down as undecided.

Mr. WOOD. Okay.

Mr. BARTON. And we will continue to dialog on this. But the chairman would recognize the distinguished ranking member, Mr. Boucher, for 5 minutes of questions.

Mr. BOUCHER. Well, thank you very much, Mr. Chairman. I welcome this opportunity to have a conversation with the distinguished members of the Federal Energy Regulatory Commission about a number of the provisions that are contained in the legislation now before us. I apologize for being absent while you made your statements. You may have actually answered some of the questions I will propound. I had to attend briefly a hearing in another committee, the name of which is rarely ever mentioned in this committee, but I do apologize. It shall not be mentioned here. I apologize for being absent.

I am interested in your views on these matters, so let me just ask all of these questions at one time, and you can respond to those questions that you choose to respond to as a group. First of all, I am interested in your view with regard to a continuation of the FERC's merger authority. I suspect you have definite views on this, and I would welcome those views. I happen to think that if we repeal your authority simultaneously with repealing the Holding

Company Act, all of the inevitable consolidation in the industry that will occur in the wake of that will produce enormous market power concerns, and you would then be perhaps powerless to address those if you didn't have merger review authority. So your response to that would be welcome.

As a second matter, I am interested in your response to the provisions in the bill that would prescribe the way in which investor-owned utilities and others who own transmission become members of Regional Transmission Organizations. It strikes me as a rather detailed prescription, and your response to those particulars would be welcome. It may be that you would prefer a simple statement in the legislation clearly confirming your authority to regulate RTO membership, and if that is the case, I hope you will tell us.

As a third matter, the bill contains provisions on incentive pricing for the construction of new transmission, and my question to you is whether that is appropriate, in your opinion, or as a possible alternative should we specifically empower, or can you empower, Regional Transmission Organizations to bid out that construction, to manage the construction and in some way through its own mechanism to achieve the goal of having new construction built in those parts of the country where new construction is required. And so your view with regard to incentive pricing and the alternative of simply having the RTOs undertake the job of bidding out the new construction would be welcome.

And, then finally, I would like to have your view with regard to the language in the proposed statute that relates to uniform interconnection standards. I know that you have a notice of proposed rulemaking out on that subject. Do you believe that you have sufficient statutory authority to adopt a standard? Do you need additional authority? And what is your reaction to the provision in the bill that addresses uniform interconnection standards? Mr. Wood, would you like to begin?

Mr. WOOD. Yes, sir, Mr. Boucher. In brief, the merger authority issue, I probably don't have as strong a feeling on that as my colleagues do. I think I share their general direction, but I also recognize that we are the only agency in the government that does that. If you want that issue to continue, then it probably should be stuck in someone else's statute that they should have the duties that we have, if there is a concern about inefficiency in government there.

I do think in just the brief time I have been on the Commission, we deal with mergers rather routinely in 90 days. There are a few examples of those that are very slow but certainly nothing like the FCC that I know the committee has been concerned with in the past.

The consolidation that will happen in the industry as a result of mergers, combined with the RTO provision, and consolidation of companies that transmit and stay regulated are probably not a big concern; in fact, it probably will happen to recognize the economies of scale. Consolidation of generation owners within a given market, yes, that would be a market power concern. Quite frankly, our tests that I just discussed briefly with Mr. Barton would, in effect, limit those companies' ability to exercise that market power as it works today. But there are two things going on there.

RTOs, I think that looking through those provisions, and there was some language there, but the main thing that when you look at successful models in the country that have set up wholesale markets that work is it is not just a transmission-owning company game. They have the assets, but there are a lot of people that play in that market, and the most successful models, the ones here on the East Coast, the one in Chairman Barton's and my home State, and others around the world, did start very broadly from a broad stakeholder participatory effort. And I think that the way some of the language goes, and I mention this in my testimony on RTOs, is a bit more focused on the right of the transmission owner to stop something, to slow it down in court, et cetera, recognizing that there are a lot more people here than just the transmission owners; it is a wholesale market we are talking about.

Mr. BOUCHER. So you would prefer not to have that language in that statute.

Mr. WOOD. Again, I think the confirming of the Commission's authority, as Chairman Barton outlined, is helpful. It was just reaffirmed yesterday that order 2000, which made it a voluntary effort, was just reaffirmed by the local court here in the D.C. Court of Appeals.

Mr. BOUCHER. Well, let me ask you the other side of the equation, though. Do you see anything in the statutory provisions, the proposed provisions in this bill, that might restrict your authority to take the kinds of steps that you are currently taking with regard to RTO membership?

Mr. WOOD. Yes, and those are what I specifically mentioned in my written testimony. So I could go through those, but, by and large, certainly the haste to get into an RTO is a positive. I think we are getting there, but, certainly, you never know until you actually get it stuck in the sand that you are there. And the nailing-down of some contours in what ought to work is positive but in some cases could be a little more detailed than we may need 5 years from now, because these will morph over time into institutions that address the needs of their customers and of their owners. And so my only concern is just a general statutory legislative type concern that very specific language, while it may work today may 5 years from now be difficult. But that is not a critical "at-the-heart" concern.

Incentive pricing, requiring bidding out, we haven't discussed this as a body, but I certainly would intend that it be an option out there that should be employed anyway to ensure that the best product for the least cost is what we get in these systems.

Mr. BOUCHER. On that note, do we need to do something statutorily to authorize the RTOs to undertake bidding out, or is this something that their basic charters could empower them to do?

Mr. WOOD. Well, I think the basic charter of the RTO could. If, however, you are in conflict with a State statute that says only a regulated utility can build a power line, as opposed to a merchant that may want to come in and invest in a power line to fix a constraint——

Mr. BOUCHER. So some provision that affirmatively empowers RTOs to bid out would be a helpful measure.

Mr. WOOD. And also follows through and says if you are in fact the winning bidder, that you have a right to move forward under perhaps some Federal authority to build that line. Then that, of course, ties back into the siting issue, which I know is quite delicate and I think was addressed pretty delicately by the bill.

And your final provision was uniform interconnection standards. Yes, we are moving forward on uniform interconnection standards with regard to the larger power plants. But as I mentioned in my opening statement, what the Barton bill does that we cannot do is really allow a broad national template to be laid for the small distributed generation that I really think is a big part of our Nation's energy future.

Mr. BOUCHER. And you would like to be able to do that.

Mr. WOOD. Well, I think we or the Department or somebody that—when I was at Texas, the Department gave the State a pretty nice grant of R&D money to actually get consultants to draft those standards. So the State of Texas has them. I understand that California and New York have similar although not exactly the same standards. And we could do a 50-state kind of approach to this here or you could have a very investor-friendly, kind of here's how it works in America approach on distributed generation, which this bill would do. It would have the standards set nationally and implemented by the States.

Mr. BARTON. We can possibly do a second round if members wish.

Mr. BOUCHER. Well, thank you, Mr. Chairman. I realize this has taken a great deal of time. This is a helpful conversation, Mr. Wood. I thank you for those answers. And in a second round, I would like to get the response of the other panel members to that same set of inquiries. Thank you, Mr. Chairman.

Mr. BARTON. Gentleman from Tennessee, Mr. Bryant's recognized for 5 minutes.

Mr. BRYANT. I thank the chairman. I would like to direct two of my first questions to the director of the TVA Board, Glenn McCullough. The first one, and I will give you the question and ask you to answer it, and then I will ask you another question after that. Keep that in mind as you answer from a timing standpoint. One of my biggest concerns is the continuation of reliable and affordable electricity to my constituents and to the people of Tennessee. Would this language in this bill do anything to jeopardize those issues of reliability and affordability?

Mr. MCCULLOUGH. No, Mr. Bryant; in fact, the consensus title language that is in tact in H.R. 3406 we believe is the best language to ensure affordable, reliable power for the people of Tennessee Valley and also to have a competitive, transparent marketplace.

Mr. BRYANT. Okay. My second question would be could you explain in some detail, if you would like, to this subcommittee some of the ways in which TVA and the distributors, the 158 customers plus, I guess, the direct-buy customers for that matter, how TVA has been preparing for the eventuality of a restructured electricity marketplace?

Mr. MCCULLOUGH. Yes. Mr. Bryant, TVA is offering partial requirements contracts to our 158 power distributors. In other words,

we are saying to the power distributor, "You can look into the market, you can self-generate, you can go with an independent power producer." We recognize that an open marketplace offering competition and choice is desirable, and TVA wants to embrace that sort of marketplace. So the consensus title language enables distributors to buy power from another supplier. With 2 years notice, they can buy 10 percent of their requirements, and now they are under full requirements contract. With 3 years length of notice, they could buy all their power from another provider.

Second, the language in the consensus title, which is contained in this bill, yields to FERC on oversight of transmission. That is a compromise, but we trust the judgment of FERC on oversight of transmission tariffs. And we feel like that that again demonstrates TVA's willingness to embrace a competitive and open marketplace.

Third, the merchant plan activity in the Tennessee Valley is vibrant and brisk. Many independent power producers are interested in locating in the Valley. There is an abundance of natural gas pipelines. We go through the FERC-ordained procedure to enable them to access our transmission grid to deliver power to a place where it is needed. So TVA is working cooperatively in compliance with FERC, with the ordained procedure for independent power producers to access our system, and, again, we think that that is in line with the energy security needs of the country.

Those are three ways that we are embracing competition and choice, and that language is contained in this bill.

Mr. BRYANT. Thank you. Let me ask one question to Mr. Wood, if I could, regarding transmission siting, which is an always an issue to me in terms of a State's and individual rights versus efforts by government, whether it be, again, a State government or Federal Government to site over somebody's private property. And there is a balance there. I would ask you to describe FERC's authority to site, in this case, natural gas pipelines. Is it the same broad authority necessary to effectively site interstate transmission lines? And what do you see on behalf of—or at least chairman of FERC, the right balance between State and regional concerns as well as individual concerns?

Mr. WOOD. Thank you, Mr. Bryant. I am probably not the strongest advocate for Federalizing this particular issue, as you might find either at the table or in the administration, but I think, having been a State commissioner, in fact, I am just filing an affidavit today in a lawsuit that I am still being sued for for putting a transmission line in South Texas, so I remember these responsibilities well and have to say from a personal level I would rather they not follow us up here to DC. But in the purpose of balancing what is in the best interest of the public, I would say largely, in my experience, the States have been able to address these issues.

The one instance I mention in my testimony where there might be a concern is if a State statute, which is not the same one I had to deal with but I understand is true in about 10 or so States, says that you have to show there is a local benefit for the placement of a transmission line. If that transmission line is meant to bring up the voltage of the entire grid but you may be at the corner of a State, it may be difficult to say that the residents of that corner of Tennessee, in fact, are benefiting from the placement of this line.

That may be more for the benefit of Kentucky. But yet that is an approval that is required by the State of Tennessee. So the regional aspects on the regional lines really would probably be the area where there is a problem.

On the addressing lines that rest largely within a single State, I can't say I have heard of any problem with that. It is when you have got regional lines. And I would suggest, as I mentioned in my testimony, that these Regional Transmission Organizations, which are made up of multiple States, their commissions, some oversight by FERC, by all the participants in those regional markets, that a proper procedure may be to put it not at the Federal level, but at the regional level to look at what the best siting is. The Western Governors have set a good template in fact for how that ought to work and that I have kind of been on record of being a pretty good fan of.

Mr. BRYANT. Mr. Chairman, I think my time has expired.

Mr. LARGENT [presiding]. Yes, sir; your time is expired. I recognize the gentleman from Tennessee, Mr. Gordon.

Mr. GORDON. Thank you. Chairman McCullough, since you seemed to be up to bat a little earlier, I will return to you. As you know, the Tennessee Valley Authority was created to help control the flooding that was devastating to a large region of the country, as well as to help with economic development to one of the poorest regions of our Nation. And with that, there was a Federal investment. Three years ago, Congress has mandated there will be no more Federal dollars appropriated for the Tennessee Valley Authority. Not only that, but the TVA's continuing to pay back that original investment, millions of dollars to the Treasury every year, which is appropriate, an agreement that was made.

I guess one thing that concerns me is that every river in the Nation the management is paid for by the Corps of Engineers except for the Tennessee River, which is underwritten by the ratepayers in that area. So it appears that not only is this a misconception that somehow there is a Federal appropriated subsidy to TVA not accurate, but TVA really is having to take up additional responsibilities that taxpayers take care of elsewhere. Would you want to comment on that if I am correct or not?

Mr. MCCULLOUGH. Well, Mr. Gordon, you are correct in every point you make. I would emphasize that while TVA does not receive any Federal appropriations, we have not in any way neglected our responsibility to manage and develop the Tennessee River and its tributaries. Appropriations, I believe, is your prerogative and the leadership of Congress, as far as TVA is concerned. We are committed to running TVA like the big business that is it, being held accountable to you and your colleagues here on the Hill. In fact, we benchmarked our performance in terms of water quality, in terms of navigation, flood control.

And you are exactly correct, in 1933, the Tennessee River was out of control, and the Tennessee Valley was flooded almost every year. That has not been the case since the dams and the reservoirs have been constructed. Not only that, we have affordable, reliable power in the Tennessee Valley. And the Tennessee Valley's economy has grown significantly, providing better jobs for the people of the Tennessee Valley.

Mr. GORDON. You had mentioned earlier in your testimony about some of the model environmental programs you were doing. Once again, these are programs that are underwritten by ratepayers, yet they are modeled for the entire Nation. Can you talk some more about those environmental initiatives?

Mr. MCCULLOUGH. Yes. We have significant water quality initiatives and amebas hydro and oxygenization program in our hydroelectric facilities to ensure that the water quality in the Tennessee Valley is among the best in the country. We are working very closely with State and Federal oversight authorities to ensure that the water—as a matter of fact, over 4 million people get their drinking water each day from the Tennessee River. TVA has a mandate to ensure that it is of the highest quality. We are working on other initiatives to modernize and in fact to generate more hydroelectricity and at the same time have a higher quality of water. And we are doing it all without a penny of federally appropriated dollars. We think it is our reason for being, it is our mission, and we think it is a responsible way to run the business. But you are correct in the points you make.

Mr. BRYANT. Thank you.

Mr. MCCULLOUGH. Yes, sir.

Mr. LARGENT. Does the gentleman yield back?

Mr. GORDON. Yes. I yield back the balance of my time.

Mr. LARGENT. Mr. Shimkus from Illinois is recognized for questions.

Mr. SHIMKUS. Thank you, Mr. Chairman. Mr. Blake, two quick questions, then I have a question for the commissioners. Does the administration support the inclusion of currently non-FERC jurisdiction transmission owners into RTOs?

Mr. BLAKE. Yes.

Mr. SHIMKUS. And based upon the President's national energy policy, do you think that the Barton energy draft meets the intent of the administration when they presented their national energy policy?

Mr. BLAKE. I think it is definitely in line with the administration's desire for comprehensive electricity legislation.

Mr. SHIMKUS. Thank you. For the FERC commissioners, I am interested in this seams agreement issue, and especially for the State of Illinois in which we currently have three RTOs or we may have three RTOs. We understand that the cost of getting electricity into one's home may be 5 to 10 percent of the cost per kilowatt hour. As someone who is concerned about the competitive benefits to the individuals in my State, can you talk me through the seams agreement, and are there things that we need to do to address this? To tell you the truth, I am kind of confused by the whole issue. And why I don't just go with the chairman and then go from my left to my right? Thank you.

Mr. WOOD. Yes, sir; let me jump in first. These are all pending, actually, I just posted the agenda for next Wednesday for our Commission, in which we will take up the seams agreement, among really a litany of issues relating to the structure of the wholesale market in the Midwestern United States. So I think I might defer to Linda and Bill, who were there actually when the seams agreements were first voted on, for giving you some specific answers.

Mr. SHIMKUS. That is great. Commissioner Breathitt?

Ms. BREATHITT. I need to speak generically about this, because there is a particular seams agreement that was worked out between two parts of the Midwestern area of the U.S. But seams are going to occur between RTOs. And the purpose of working out seams agreements between RTOs is to minimize the flow of electricity between the seams. So the protocols don't impede—the protocols that one RTO has don't impede the flow of electricity from one region to the other, from two different RTOs.

So that is one way to address the ability for power to flow from one to the other is through a seams agreement that might address procedures and protocols or rates even, or congestion bottlenecks. So they can address those very important aspects, and that is what I think will be important for us to make sure our agency encourages, because you are going to have a number of RTOs within the United States.

Mr. SHIMKUS. If I could follow up. A good seams agreement, could that help forestall some market power abuses? Could there be market power abuses because of poor seams agreements and the like?

Ms. BREATHITT. Market power abuses can occur whether you have a seams agreement or not, and those need to be dealt with through a number of ways. But a seams agreement, per se, may not directly address market power. But what a seams agreement can help minimize is the inability for power to flow easily between regions and markets.

Mr. SHIMKUS. Commissioner Massey?

Mr. MASSEY. Mr. Shimkus, a couple of years ago, when this issue came before the Commission, the question was whether we should encourage a seams agreement in the Midwest or encourage the formation of a single RTO. And my vote——

Mr. SHIMKUS. And we are still debating that.

Mr. MASSEY. Yes. Well, my vote at that time was in favor of a single RTO for the Midwest. However, a seams agreement can be a good thing. It depends on how well it is enforced and how well it is complied with. I think it can help to mitigate market power. I think it can ensure that power flows freely across the seam without trading difficulties. In particular, it can help deal with the critical issue of how to manage congestion on the grid. But I think a better solution in many parts of the country is simply to ensure that the RTOs are appropriately sized to start with.

Mr. SHIMKUS. Mr. Chairman, my time is expired, and I will quit my questions.

Mr. LARGENT. Yes. Mr. Sawyer from Ohio is recognized.

Mr. SAWYER. Thank you, Mr. Chairman. I just want to observe that these exchanges I think have been extraordinarily helpful, and I am particularly grateful that we took the time to have these hearings this week.

Let me touch on a couple of observations that you made, Chairman Wood, and one that I made. The first is that even at a time when transactions and generating capacity has been—or investment has been growing, the transmission really has been in a very long, slow decline. It seems to me that that is the single most de-

bilitating impediment to achieving the goal that we are all talking about here.

At the same time, in your testimony, you suggested that infrastructure investment suffers from the uncertainty of the long transition to competitive wholesale electricity markets. I am inclined to agree with that. Can you talk to me briefly, or other commissioners, about the steps that have been taken to increase the certainty and what steps you need from us to help you achieve it? I would be happy to hear from other commissioners as well.

Mr. WOOD. A great question. In 1996, the Commission in what was called Order 888, put down the first—I guess the first book of the trilogies and said, "We are going to open these wholesale markets." That now was argued before the Supreme Court shortly after the attacks, and we expect a decision on that in the spring. Order 2000, which was the step that was taken in late 1999 says, "Not only are we going to fix this on a utility-by-utility specific basis, but we want to encourage the development of regional groups that look at electricity on a regional basis, which most people acknowledge makes a lot of sense." So that was actually affirmed—that order was affirmed yesterday by the D.C. Court of Appeals.

So now we are implementing those two orders of the Commission on a utility basis and on a regional basis, and so those steps are going forward. They are tediously slow, from my perspective. Investors, I know would look for somewhere else until these rules got clarified. That is why we have now announced that we are going to finish the trilogy with the "third book," which will be saying not only do we want these things and we think they are a good idea, but here is what we specifically want them to do, so that investors know these are the rules of the road for investing in a transmission business from now for 10 years.

We were at Wall Street last week. I heard that message in spades, even in the post-Enron——

Mr. SAWYER. We have as well.

Mr. WOOD. Yes.

Mr. SAWYER. What do you need from us to help you facilitate this and move——

Mr. WOOD. Yes. And I am sorry I didn't put this in my testimony, because it is an idea that I actually heard in discussions from an exasperated participant in these markets, that no matter what the committee does by adding incentive rates to the legislation or the Commission does to pull it all together, at the end of the day, the bulk, say 90, 80 percent of the revenues that a transmission company would spend would be ultimately paid by—or would be paid by a ratepayer that is retail-regulated by our colleagues at the States. The split jurisdiction between—we have jurisdiction over some of the transmission—over all the transmission access, some of the transmission rates—encouraging transmission to be built, with the States collecting 80 percent of the dollars, they may not agree that it gets built.

Mr. SAWYER. Could we just have a quick commentary from other commissioners?

Ms. BREATHITT. I think this is something that our agency can do and you asked for something that Congress could do, but may I spend 30 seconds on that?

Mr. SAWYER. Sure.

Ms. BREATHITT. State returns are often a couple or several hundred basis points over Federal returns on transmission. One thing that the FERC can do is make those more comparable so it incents transmission owners or transmission companies to build.

Mr. SAWYER. Others?

Ms. BREATHITT. We have heard that.

Mr. SAWYER. Other comments?

Ms. BROWNELL. I would simply add that I think we could clarify with one simple statement or authority to establish RTOs. I agree with my colleague on incentive rates, but you need to give incentive rates to innovators, not for people to continue their jobs the way they have always done them. Because that will bring the changes that you talked about.

Mr. SAWYER. Commissioner Massey?

Mr. MASSEY. I believe that you are moving in the right direction in placing transmission under one set of rules. I think that is critically important. Right now about 30 percent of the grid is exempt from the open access requirements directly. No. 2, I do think it is important for Congress to make a statement about RTOs and their importance to evolving regional markets. It would be helpful to have a clear statement from Congress that we can insist that these institutions be formed. Otherwise we may continue to have a patchwork because a particular State may, for example, have its own statute that says you can't transfer control of any transmission assets in this State or any assets at all without the approval of the State Commission. And if they withhold that approval, we may still have a patchwork in some parts of the country. So I think it needs to be clear that the Federal entity that is responsible for regional markets can get this done. And, No. 3, I think we do need mandatory reliability rules.

Mr. SAWYER. Thank you for your flexibility, Mr. Chairman.

Mr. LARGENT. I recognize the gentleman from Oregon, Mr. Walden.

Mr. WALDEN. Thank you very much, Mr. Chairman. I want to thank the chairman of the subcommittee specifically for working with us for the inclusion of a Northwest title, because similar to my colleagues from Tennessee and who are representing the Tennessee Valley Authority, the Northwest is indeed unique in its power system and the way it operates and how we are working together to form regional RTO out there. So I appreciate the subcommittee chairman's work with us on inclusion of that title.

There was a little present associated with that section of the bill, however, that I hope to work with the full committee chairman on, and that is the section 525 language that deals with continuation of preference power for the DSIs in the Northwest. They have been under enormous pressure of late because of power costs and yet represent 40 percent of the Nation's supply of aluminum and are important employers in the region. My concern is that this inclusion may indeed blow up talks that are ongoing right now in the region, and so I draw the committee's attention to that.

I wanted to follow-up a little bit on FERC's—the language in Section 401 that would expand oversight over transmission networks on reliability and support. And I wonder, some of the comments I

have received indicate that FERC already has that authority to approve incentive transmission rates that are just and reasonable. Do you feel you need this additional authority?

Mr. WOOD. Sir, it wouldn't hurt. I think a lot of things that were not written in the 1992 law or in the 1935 law are subject to being challenged by court, and my experience certainly at the State level if issues related to ratemaking are not clear enough from the statute, they certainly become litigation targets. And if Congress deemed that this is a good goal, and I would agree that it is a good goal, then it would be helpful to put that in the statute, clearly that authority is here.

Mr. WALDEN. Do you feel that it will result in construction of additional transmission facilities? I mean is there a guarantee that comes with this for consumers?

Mr. WOOD. No, no, no. I think as with ratemaking in general, you give somebody sufficient revenue, sufficient return, you have a high expectation that they will deliver on that but no guarantee.

Mr. WALDEN. One of the other concerns would come out of Section 101 of the bill, the interconnection standards—and this may have been addressed in some earlier discussions I think my colleague from Virginia raised—about whether FERC has the technical expertise to set some of these very technical standards. How would you go about that? Are you going to rely on the IEEE standards?

Mr. WOOD. The current process that we have going on now is very much a collaborative effort with the industry, with, quite frankly, the Commission staff playing a catalyst and shepherding role, getting the experts together on talking about issues of this nature. It is clearly the right way to go forward. IEEE standards—I know from having done this back in my home State, IEEE standards fill a lot of that effort, a lot of the contract revised back on the industry standard setting bodies to that, which is referenced in the statute.

Mr. WALDEN. I think that is all the questions I have at this time, Mr. Chairman.

Mr. LARGENT. Okay. The Chair recognizes Mr. Markey for his questions.

Mr. MARKEY. Thank you, Mr. Chairman, very much.

Mr. BARTON. Would the Chair suspend just a second? This will be our last questioner before we go, because we have six votes. So we will do Mr. Markey, and then we will recess, and then we will come back at approximately four o'clock. I don't see how we can do six votes in less than that time.

Mr. LARGENT. Mr. Markey is recognized.

Mr. MARKEY. Thank you, Mr. Chairman. It seems to me that the Enron collapse raises some fundamental questions about the nature and the adequacy of oversight over the traders who are marketing electricity. If in fact the transactions that are now raising eyebrows wee intended to conceal trading, our investment losses, what does that say about whether we can continue to allow these energy trading firms to be completely unregulated? When it comes to banks, security firms and commodities markets, we have Federal regulators in place that have holding company, risk assessment authorities, authorities to set capital standards and margin rules,

audit trail and recordkeeping authorities, large trading or large position reporting requirements, and anti-fraud and anti-manipulation authorities, backed up with market surveillance systems and enforcement powers.

But when it comes to electricity trading, we really don't seem to have that type of regulatory infrastructure. Don't you think, Mr. Chairman, that we should put such a regulatory structure in place so that we can make sure that any future potential Enron collapse is much less likely to ever occur.

Mr. WOOD. Thank you, Mr. Markey. One of the major features of the RTO rule that was just affirmed yesterday by the D.C. Court of Appeals is that we have a market monitoring section that looks at the regional transactions on a hour-by-hour, minute-by-minute basis. We have the ability now certain in the Northeast and your area, as well as on down through here, with our oversight of the markets that have already been organized up here. So you monitor transactions on a—transaction-by-transaction basis and we do. That information is valuable, it is very helpful. The fact that the local monitors and at the Commission are looking at that, and on occasion acting on that information is very helpful. We do not have the capability across the entire country, because quite frankly the markets across the country are not that organized. It is difficult without an organized market to have much oversight of a lot of disparate activity.

Mr. MARKEY. What is your authority to regulate a non-utility electricity trader like Enron?

Mr. WOOD. Well, they, actually, under the act, would be considered a public utility. The way that the utilities—they don't own the wires in this, but they have a marketing certificate just as I have discussed with some other questions earlier. There are 1,200 people that have market certificates——

Mr. MARKEY. So you believe you have existing authority.

Mr. WOOD. We do, and in the past we have waived our accounting requirements for the last 10 years of these unregulated parties, because we don't set their rates. The main reason we have accounting requirements is not to protect sophisticated players in the market, but to protect the customers.

Mr. MARKEY. So what are you going to put in place post-Enron?

Mr. WOOD. We just posted this afternoon—this morning—our agenda for next week, and we were taking up an item which interestingly was work already going on to reflect the changes in accounting for derivatives and for hedging instruments that we were looking from a ratemaking point of view but we are considering looking at that for more of a disclosure point of view.

Mr. MARKEY. Would that allow you to look at the capital structure of Enron?

Mr. WOOD. That is an open question. That would be certainly something we would ask the—it would be a notice of proposed rulemaking. So at the phase of asking in public——

Mr. MARKEY. Do you have the capacity and do you believe you have the inherent authority to look at the capital structure of these companies, if you put such a rulemaking in place?

Mr. WOOD. The statutory authority, yes. The technical expertise on our staff at present to discern that, I would have to get back to you on that, sir.

Mr. MARKEY. Mr. Massey?

Mr. MASSEY. Well, I think we have the authority to look the capital structure. Whether we should is a matter that I am open to argument about. We certainly have the authority to take a look at the current exemption that we had in place, as Pat says, for about 10 years, an exemption from our uniform system of account filings for about 1,200 power marketers and sellers, because we don't generally regulate their rates. However, we have conditioning authority that we can use in reasonable ways.

Mr. MARKEY. When you say you are open, who else would do it but you? Who would have responsibility but you? You are the expert agency in the field of energy trading.

Mr. MASSEY. Well, we definitely ought to consider what the lessons from this are for energy trading, and I think we will.

Mr. MARKEY. Let me just—I know my time is going to run out—l just want to run down yes or no, and I would like you and the chairman to each answer. In your opinion, do you have the power and intent to establish, one, capital requirements? Chairman Wood?

Mr. WOOD. I am not given enough of a question to give you a thoughtful answer. I will be glad to do so.

Mr. MARKEY. Mr. Wood—I mean Mr. Massey?

Mr. MASSEY. I think we have the power——

Mr. MARKEY. Yes or no. I mean I am going to run out of time.

Mr. MASSEY. Yes, we have the power. I don't know whether we ought to establish those standards.

Mr. MARKEY. Okay. Ms. Breathitt?

Ms. BREATHITT. Mr. Markey, we have also included in a recent rulemaking electronic trading platforms to come in under our standards of conduct.

Mr. MARKEY. Capital requirements, yes or no?

Ms. BREATHITT. I haven't studied that, but I——

Mr. MARKEY. Okay. That is fine. I think you should study it. Next——

Ms. BREATHITT. I have the intent.

Mr. MARKEY. The intent, that is good. I just need you—margin requirements, yes or no?

Mr. WOOD. Same answer.

Mr. MARKEY. Answer is?

Mr. WOOD. I will get back to you.

Mr. MARKEY. Okay. Ms. Breathitt?

Ms. BREATHITT. I haven't looked at it, but I would have the intent to do it if we can.

Mr. WOOD. If we have the authority, I am willing to look at it.

Mr. MARKEY. Ms. Brownell?

Ms. BROWNELL. I think it is important we work with other financial oversight agencies to make sure that we having a coordinated appropriate response, which would include, Congressman Markey asking these questions. But in many cases, from what we have seen, these are financial issues, so I just want to make sure that the right agency is looking at the right thing.

Mr. MARKEY. They are exempted from many of those other agencies' regulations. I mean you won't be responsible. Auditing and bookkeeping requirements?

Mr. WOOD. The answer to that is that we do have the authority certainly on the physical delivery of the power, and that is what I mentioned to you a moment ago that would be subject to our discussions next week in our open meeting.

Mr. MARKEY. Ms. Breathitt, very quickly, and then I am going to——

Ms. BREATHITT. Yes.

Mr. MARKEY. Yes.

Ms. BROWNELL. Yes.

Mr. MARKEY. Yes.

Mr. MASSEY. I answer the same as Chairman Wood.

Mr. MARKEY. Okay. And the large trader or large position reporting, so you know what is going on in the market.

Mr. WOOD. Same answer on the accounting side. Yes, sir. I think that is certainly something that would come up next week in our discussions.

Ms. BREATHITT. I agree with the chairman's response.

Ms. BROWNELL. As do I.

Mr. MASSEY. I agree, and I think we ought to take a close look at that.

Mr. MARKEY. And, finally, anti-fraud and anti-manipulation rules applicable to trading activities.

Mr. LARGENT. This will be the last question.

Mr. MARKEY. Okay. Thank you.

Mr. WOOD. I do understand that the other two agencies do have authority over fraud issues, and I would certainly defer to their expertise on that. But if they don't I am not aware that we do have that authority. But we will certainly look for it and I will get back to you on that.

Mr. MARKEY. Would you want that authority?

Mr. WOOD. I think anything that diminishes customers' faith in the efficacy of markets ought to be vested in us or somebody.

Mr. LARGENT. Gentleman's time has expired. I yield to the chairman of the subcommittee for a brief statement.

Mr. BARTON. Before we break for the recess, I want to follow-up on some of Congressman Markey's questions just briefly. There is absolutely no question that the collapse of Enron's stock price has wiped out many of their pensioners, many retirees around the country. I mean it is a major, major calamity, and nobody is taken away from that. Until this year, until this Congress, this committee had jurisdiction over the financial industry also. So you had one committee that had energy jurisdiction and also security jurisdiction. And both Mr. Markey and I are very unhappy that we lost the security jurisdiction to the new Financial Services Committee.

I am not taking away from the collapse of Enron, but in terms of the energy markets, is there any evidence that because of the collapse of Enron and the disappearance of Enron Online, that power was not sent where it was supposed to have been sent? Did the market fail in the sense of energy getting to where it was contracted to go?

Mr. WOOD. In fact, no. No, sir. The physical deliveries of gas have continued, and in fact I think the big story here is that the markets really didn't hardly hiccup at all.

Mr. BARTON. So we have got an accounting disaster with Enron and a financial reporting disaster and probably a partnership creation problem, but we don't have an energy market problem.

Mr. WOOD. No, I think energy markets performed admirably well in the past couple of months on this issue.

Mr. BARTON. Thank you, Mr. Chairman.

Mr. LARGENT. Well, we will recess this hearing until four o'clock, and I know that the chairman of the subcommittee feels Enron's pain.

[Brief recess.]

Mr. BARTON. If our panelists are still in the room, they could resume their seats. And if we have—do we have a member back there, anybody? It is Mr. Norwood's turn.

The subcommittee will come to order. When we recessed, Mr. Markey had asked his 5 minutes of questions. We now go to the majority,and Mr. Norwood of Georgia is recognized for 5 minutes for questions.

Mr. NORWOOD. Thank you very much, Mr. Chairman. I am delighted about this hearing and, as others on the committee, I am very concerned about Federal deregulation of electricity, I am concerned about its unintended consequences, and I want to take this opportunity to see if we can't clear up some things.

It seems to me that we all ought to be a little concerned about deregulation of electricity. We have noted the deregulation in California, and the consequences of that was generally the cost to the ratepayer. Enron, the poster boy for deregulation, right or wrong, has ended up hurting people. And in my own State of Georgia, we were one of the first States to deregulate gas. And though it looked right, it appeared right, everything should have been right, but in the end it turned out to be a very costly mistake to the ratepayers in Georgia. So it is right and correct that we have great concerns about this.

Now, just so you know where I am coming from, I come from the State of Georgia. We are very happy with our utilities there. That includes the coops, that includes the munis, that includes Souther Company, that includes Georgia Power. And, frankly, the reason we are very happy with them is that the give us very good service at very good rates, and we want to be sure that the FERC doesn't do anything that it might help somebody else but at a great cost to us locally.

I want to thank all of the Commission members for being here, and I am going to direct my questions to the chairman in hopes that because of time limitations the rest of you would be kind enough to at some point in time be willing to respond too.

Mr. Wood, it has been a while since I have had as many people as upset coming through my office here and in Augusta with you. It has been a long time since a Federal agency has generated quite so much concern. I have been, frankly, amazed. And in view of our good relations with our utilities and our good relations with the consumers, many of whom I know well as voting citizens and friends, it is just rather been amazing.

Of course, I tried to defend you and tell them you were from Texas, couldn't be all bad. But I——

Mr. BARTON. All bad?

Mr. NORWOOD. All bad.

Mr. BARTON. All good.

Mr. NORWOOD. I sort of have stopped defending you. I read the other day in Energy Daily, I think it was September the 26th, of an interview, a remarkable interview that you had, and in that interview there is a quote of yours reported in that article from the Senate hearing that you were talking about punishing regulated entities, regulated utilities. Now, the quote says, "A few heads on the stakes around the campfire may make all the animals behave a lot better in the forest." Is that accurate?

Mr. WOOD. I recall saying that; yes, sir. Not in that context, I would like to explain, but——

Mr. NORWOOD. Well, that is accurate. That is the first thing, so I don't have to go check the Senate record. I guess probably where I am coming from a little bit here is I have got a great curiosity about whose head you want to put on a stake, and I have even got more interest in that if any of those people are friends of mine. And I am beginning to think maybe that might be the case. In Georgia, when we start talking about animals and campfires and forests, we are usually talking about deer hunting. Are you a deer hunter?

Mr. WOOD. No, sir.

Mr. NORWOOD. I don't know why I sort of suspected that. But that is a quite a metaphor. And I want to—I am going to get back to that in a little while, but I want to just get right at the bottom line in here, and it is going to take a while, Mr. Chairman, so I hope you will have a few rounds.

I am curios to know about this order from November the 20th revoking market-based rates of two or three companies that were singled out, one of which was Southern Company, which apparently shifts the cost of doing business from wholesale to retail and how this is going to affect the retail customer in Georgia. Now, I suspect that it is going to affect the retail customer in Georgia and probably not in a good way. I would just like to make sure that when FERC goes utility hunting they don't end up shooting the customer. And that is really the bottom line. I really think we all sort of agree with that. That is really what this is about, isn't it, the ratepayer and trying to give them the least costly electricity with the best service.

When you decided that you wanted to force these companies into not being able to use market-based rates, were you aware at the time that in Southern Company at least the profits they make by selling power at market-based rates goes back to our retail customers to reduce their rates. At least 90 percent of the profits do. So in the end, those profits are used by our utilities to reduce what a member of the household might pay. I heard you talking about customers earlier, and I am not talking here about industrial customers; I am talking about folks at home. We you aware of that fact when you decided that market-based rates wouldn't be good enough for these companies, guilty or not?

Mr. BARTON. This will have to be your last question in this round.

Mr. NORWOOD. I am just warming up, boss.

Mr. BARTON. I know you are just warming up, but you are 2 minutes over in this warmup period.

Mr. NORWOOD. All right. Well, could the——

Mr. BARTON. He can answer.

Mr. NORWOOD. [continuing] Chairman answer? Thank you.

Mr. BARTON. If he has a good answer. We won't accept bad answers.

Mr. WOOD. I have several. Could I respond to the full list, sir? Is that appropriate?

Mr. BARTON. You have got the right.

Mr. WOOD. My comment on the animals in the forest, sir, related to people who are violating the Natural Gas Act or violating the Federal Power Act. And if they are in the context of all the California issues, we were looking at market power and anti-competitive conduct, at physical and economic withholding of power from the market, those type of things. Those are people who are violating the law, and those are the people whose heads should be on the stake.

Mr. NORWOOD. And you should do that, but don't put innocent people's head on the stake in the process of one-size-fits-all.

Mr. WOOD. I agree with that. We will not do that, sir. Our job is to go through due process. In fact, we have got a number of enforcement actions at the Commission today. Some may result in the finding of guilt, some may result in the finding of innocence, but we go through that process first.

As to the order on November 20, we took the oldest three people in line that we told 3 years ago we are going to look at this every 3 years and see if it still matches what is going on in the marketplace. We learned from California—as an answer to Mr. Barton's question a moment ago, we learned from California that you could have a deregulated marketplace or you could have one that gets out of control as that one did, that necessitated the Commission to come in and put what I think, as a market-oriented person, was a very prescriptive and I think a difficult non-market-based solution on top of that market.

What we sought to do with our new policy, which we discussed through the summer and voted on, on September 26, at that same meeting, and implemented on November 20 with these first three applicants—there will be others that either pass it or don't pass the test, coming up at this next meeting next week—is updating a policy that we have all acknowledged is broken and does not appropriately address market power. And if the profits from the market were being used to refund the California retail customers, our job is to look after the wholesale market as well. Those profits are coming from a market that may have resulted in some of the wholesale customers paying too much.

So what we are looking at here is a balance of all the customers. I think my colleagues on the Georgia Commission are totally capable of making sure that the retail customer stays protected in that State, but our job is to make sure that the wholesale——

Mr. NORWOOD. Not if you force the wholesale basic utility company to raise rates that they can't help raise them because you are forcing them to sell their generated power at a different rate; in

other words, at a cost rate rather than a market rate. They lose money.

And my question was do you understand that 90 percent of that money goes for the retail payer and helps then reduce the retail rate?

Mr. WOOD. Yes.

Mr. NORWOOD. You understood that.

Mr. WOOD. Yes, sir, and we had that same policy in Texas when I was a regulator, as do most States.

Mr. BARTON. We are going to have to suspend this question for this period. So we are going to go to Mr. Waxman now for 5 minutes.

Mr. WAXMAN. Thank you very much, Mr. Chairman. Before I ask some questions about this legislation before us, Mr. Blake, I wanted to ask you, I understand you have been deeply involved in ongoing discussions within the administration about changing the new source review air pollution requirements under the Clean Air Act; is that correct?

Mr. BLAKE. Yes, sir; I have been involved.

Mr. WAXMAN. The utility industry has been the strongest proponent of rolling back these important air pollution protections. Have you met with or otherwise received the views of the electric utilities or other industry sectors on this topic?

Mr. BLAKE. Yes, sir.

Mr. WAXMAN. And have you met with the environmental groups on this topic?

Mr. BLAKE. Yes, sir.

Mr. WAXMAN. Will you provide to the members of this subcommittee with a list of the names and dates for all these contacts?

Mr. BLAKE. Yes, sir.

Mr. WAXMAN. I thank you for your cooperation.

In your testimony, Mr. Blake, you repeat seven goals for electricity legislation: Reducing uncertainty, increasing wholesale competition, strengthening transmission, increasing supply, lowering prices, protecting consumers and improving reliability. I am disappointed that promoting cost effective energy conservation doesn't even make your list. We all know that you can't improve reliability by addressing supply and not demand for electricity. That is like trying to balance the budget only by raising taxes and never controlling spending. Your testimony also calls for modernizing electricity law but not our power sources. In fact, you urge repeal of the PURPA provision supporting renewable energy sources. Electricity legislation should promote not disadvantage clean, renewable energy sources.

And, finally, you make no mention of environmental protection. We now have evidence that our air pollution has increased under restructuring to date. It appears that you have fundamentally changed our electricity system without protecting air quality from the effects of restructuring. Does the administration believe that energy conservation, promotion of renewable energy and environmental protection must be goals of any electricity restructuring legislation?

Mr. BLAKE. Yes, sir. And I would just comment that there are provisions in the legislation that we noted the administration sup-

ports, such as advocating net metering as well as distributed generation. In terms of emissions increase, I am not quite sure what the baseline comparisons are pre- and post-deregulation that would suggest that opening up markets has resulted in greater pollution. In fact, most of the experience over the last several years has been the addition of new cleaner natural gas-fired turbines around the country, and I would suspect that if you looked at a per GDP basis that you would actually see a substantial reduction in emissions that we gained through opening up the markets, rather than an increase.

Mr. WAXMAN. Thank you. Mr. Chairman, I have a report from Synaps Energy Economics, Inc., a retrospective review of FERC's environmental statement on open transmission access, and the summary—both the summary and the report I would like to have the committee receive for the record.

Mr. BARTON. Could we have an opportunity to have the committee staff look at it?

Mr. WAXMAN. Certainly.

Mr. BARTON. I am sure we will put some version if not the whole thing in, but we would like to at least review before we agree to put it in the record.

Mr. WAXMAN. And since I have a second more, Mr. Blake, would you agree that using energy more efficiently can boost our economy, enhance our energy security and help the environment?

Mr. BLAKE. Yes, sir.

Mr. WAXMAN. Thank you very much, Mr. Chairman.

Mr. BARTON. You still have a minute and 20 if you actually have more—we have got the clock set at 2 minutes. It goes yellow, so you have got a minute and a half if you still want to use it.

Mr. WAXMAN. Thank you. You are very kind, Mr. Chairman, but I am going to yield it back for one of the other members to take advantage of that opportunity.

Mr. BARTON. Okay. We thank the gentleman from California. Gentleman from North Carolina, the very patient Mr. Burr, is recognized for 5 minutes.

Mr. BURR. Thank you, Mr. Chairman. Chairman Wood, what is your definition of market power?

Mr. WOOD. The ability in a real-time market to affect price by withholding supply.

Mr. BURR. Can that be also achieved because an entity has limited competition?

Mr. WOOD. Yes. He can withhold a certain amount of supplies, whatever the market is. He has the ability and no competitive check.

Mr. BURR. Could it be affected because the general capacity was not adequate to meet the need?

Mr. WOOD. Yes.

Mr. BURR. So there are multiple reasons that there could be a spike in price other than a company that just wanted to gouge consumers; am I correct?

Mr. WOOD. Yes, absolutely.

Mr. BURR. And the end result of that would resemble market power abuse in every case. Price would go up because something had happened to supply; is that correct?

Mr. WOOD. Correct.

Mr. BURR. And how would FERC determine on the spot—I take for granted that there is a process that you go through. How long would that be to determine whether there was a market power finding?

Mr. WOOD. Well, quite frankly, it could take a year. I mean we have been looking at the California market for quite some time. There have been——

Mr. BURR. And what effect would that have on Wall Street's view of the electric industry, the companies that make it up? What effect might that have on the availability of capital for new generation, given that every potential charge, every potential bill that goes out is susceptible to a refund determined by FERC over some period of time yet to be defined?

Mr. WOOD. I think it could be a problem, and we have got—as you may know, there is a pending item that we have out for comment from the parties on just that issue.

Mr. BURR. Has the Commission ever had a finding of market power?

Mr. WOOD. Well, we have a pending case regarding natural gas on that issue, but I have not——

Mr. BURR. Did we find a market power abuse in California? Is there a finding of market power in California?

Mr. WOOD. Not from a specific player; no, sir.

Mr. BURR. Let me read Mr. Massey's comments. I think these were from the debate over E47. And I quote, "has concerns about the tariff conditions, because it requires a showing of bad behavior for FERC to order refunds." He argued that "FERC has never been able to show bad behavior, even in California." Unfortunately, he would add another test, a bad market test. But, clearly, through the information I found, there has never been a determination of finding of market power in California.

Mr. WOOD. That is correct.

Mr. BURR. Biggest spike in electricity pricing.

Mr. WOOD. In the electric markets; yes, sir.

Mr. BURR. Now, given that there is a mechanism that you have proposed, FERC's proposed, that would force the automatic refund, would Wall Street respond differently if California were to happen a second time with still no finding of market power?

Mr. WOOD. I was asked this question last week. Commissioner Brownell had the opportunity to meet over 2 days with a number of Wall Street analysts and investors. And quite frankly, the issue of the refund authority for anti-competitive behavior I think was viewed in its proper context, which is a customer protection issue that, like a nuclear bomb, would never be invoked. I don't perceive that that is——

Mr. BURR. Well, a customer protection could also be extended to our inability to allow people to compete to supply power within a given power, because that created the same price spike as somebody that withholds power, right?

Mr. WOOD. I am sorry, can you repeat that, Mr. Burr?

Mr. BURR. You said earlier that you get the same result when you limit competition in a given market. So if potentially you are

holding people liable, shouldn't we hold those liable that limit competition in a marketplace, because they artificially affect the price?

Mr. WOOD. If I missed something——

Mr. BURR. I am trying to decide the scope of what FERC would like, as a Commission, to be involved in.

Mr. WOOD. Well, I think, certainly, we would like the market to be open and transparent and full of diverse number of players whose——

Mr. BURR. And is it transparent when every potential sale of electricity is susceptible to a refund under a determination that FERC will make on an undetermined amount of time?

Mr. WOOD. I have to admit I don't believe that this is actually a cloud at all. I don't think——

Mr. BURR. Well, given that there has been no finding of market powers, why are we so insistent on this new rule that deals with market power?

Mr. WOOD. Again, you are talking about the refund authority on the anti-competitive?

Mr. BURR. Yes.

Mr. WOOD. The anti-competitive behavior, quite frankly, if somebody were making a business plan of making money off of anti-competitive behavior, I would expect that we would not allow them to be in this market. And so I think those are the only people who are going to be negatively affected by the condition that we placed in all the power marketer certificates.

Mr. BURR. Because I am out of time, let me just turn to RTO's for just a second and follow Mr. Norwood with something dear to me, and that is the GridSouth. GridSouth was approved——

Mr. WOOD. Initially; yes, sir.

Mr. BURR. Yet it is not operational. What is the problem that FERC has with GridSouth?

Mr. WOOD. The GridSouth, again, was approved before I joined the Commission. GridSouth was given conditional approval with the urging that they approach their neighboring RTO proponents in Florida and Georgia and other States to increase the scope, the size of the relevant area over which the RTO would have control. And so the condition for the approval was that there be sufficient scope and——

Mr. BURR. My interpretation of Order 2000 left a tremendous amount of flexibility on governance and market rules. But now it seems like what we are calling for is a standard market rule. We have approved you to do an RTO, but now we want to set some new conditions in there so we don't this to be operational. You have been approved, but you have not met rules that we have yet as a Commission to decide what they are going to be. Is that an accurate statement?

Mr. WOOD. We are engaging in a rulemaking for standardized market designs so that we don't have the seams issues that Commissioner Breathitt pointed out.

Mr. BURR. How long have we been in that now?

Mr. WOOD. I am sorry?

Mr. BURR. How long have we been in that process?

Mr. WOOD. We announced that we were doing the rulemaking on September 26, and we intend to be complete on that by this summer.

Mr. BURR. If I heard you earlier, you, in an answer to a question—and I know my time is up, Mr. Chairman—basically said, as it related to merger authority at FERC, that you didn't have heartburn if that was taken away. Did I understand you accurately or is that something you are passionate about maintaining with the jurisdiction of.

Mr. WOOD. I think you could characterize me as thinking it is appropriate to have it at FERC, but I think Congress has a right to put these issues where they want to put them, and I don't have as strong an opinion about that as Commissioner Breathitt may. So I mean to be fair as to who might be the best one to discuss that, I probably wouldn't.

Mr. BURR. That is why I chose you. I thank the chairman.

Mr. BARTON. Thank Congressman Waxman. He yielded his time to me to use at my discretion, and then recommended that you be given his 2 minutes. So you owe——

Mr. BURR. I thank the gentleman from California.

Mr. BARTON. [continuing] you owe Mr. Waxman for that extra 2 minutes. The Chair recognizes himself for the second round of questions for 5 minutes, and we hope that the second round we can get all members' questions on the record.

I want to go to Mr. McCullough, because I haven't asked you a question yet. I understand that the TVA is considering leasing one or more of its unfinished nuclear power plants to a private entity, and then the private entity would put up the operating—put up the capital necessary to finish the plant and then lease it back to the TVA. I am extremely, and I want to triple extremely skeptical of such a plan. So would you like to elaborate on whether this just some private developer's wish list or is something you are seriously considering ?

Mr. MCCULLOUGH. To my knowledge, we don't have any specific proposal that would be specific in terms of some sort of lease proposal regarding Bellafonte. I assume it would be the Bellafonte site or perhaps Browns Ferry Unit 1 or Watts Barr Unit 2. There are all sorts of concepts, and people who are interested in submitted proposals to TVA we accept those and we evaluate them in a business-like manner, and we respond.

Mr. BARTON. Well, I think I would have to look at the TVA stats written. I don't claim to be an expert, but certainly if TVA wishes to finish those plans and operate themselves, you have got that opportunity and that right. I would support legislation if it would require legislation. If you want to dispose of them and basically privatize them, let those plants be put up on the market for private utilities to come in and bid and finish out. I would go that way, but I am extremely leery to kind of have something that is half fish and half fowl, that you have a government entity that still owns it, it is financed by private capital, and then it is leased back to the government entity. That does not sit well with me.

Mr. MCCULLOUGH. I recognize and I don't disagree with the points you make, Mr. Chairman.

Mr. BARTON. Okay. I want to give Commissioner Breathitt an opportunity to comment on the market-based rate authority that came out, because it is my understanding that you had a dissenting opinion. So I want to give you a chance to dissent, because from what I know I share most of what you dissented about. If I can't be more leading than that, let me know and I will try again.

Ms. BREATHITT. Well, you have just given me an opportunity to restate my views, and I would like to start by saying that I agree with my colleagues wholeheartedly that the Commission does need to come up with an improved way to determine applications for market-based rates, that we may be in, or we are in, an era in the evolution of electricity markets that the hub-and-spoke analysis is probably not serving the public as it used to. So we all agreed that we needed to come up with a new permanent way to assess applications for market-based rates.

That given, what I disagreed with, Mr. Chairman, is the interim measure that the Commission decided upon for determining market-based rates for those companies coming up for their 3-year review and those entities asking for market-based rates for the first time. I disagreed with the interim method. Would you like to know why?

Mr. BARTON. Yes.

Ms. BREATHITT. I disagreed with the interim method because I felt that it made the finding already that entities were engaging in anti-competitive behavior without giving the entities a chance to say that they weren't and our Commission saying, "Yes, you were, and here's the cure." I think back to when we approved the AEPCSW merger, and we found, using the hub-and-spoke, that there was a potential for market power, and the cure was that they had to sell one power plant and that that would eliminate their ability to exercise it. In this instance, we said that every power plant had to go back to cost-based rates, and I felt that this interim test was too blunt, that it didn't make a more finely tuned assessment; that was one part. The other was that it didn't give the parties an opportunity to say whether they thought that was the best way we could come up with an interim approach.

And the final point that I disagreed with was that it could have unintended consequences, which we have already seen in a new application. In another area of the country, an entity has declined to sell power into an area where they failed the test. So the power from that new plant will never be sold into an area in Virginia because—I don't think that is what we intended, but——

Mr. BARTON. Well, my problem is that we are trying to create a real national market while protecting the rights of specific States. If they don't want to open their markets, they don't have to. We are not trying to preempt that. But if you are concerned about market power, the way to prevent it, in my opinion, is to create a real market so there are a lot of potential suppliers going into the market. You have adequate transmission capacity to get the power to the market. You do that and no one player that is supplying power can dominate the market. So I would rather address market from a market initiative than from a regulatory initiative.

And any time even the best—we have got four very bright people here. And to some extent, I know all four of you personally, and

I have the highest opinion of your intellect and your willingness to do good public service. But when four or five people try to develop a market test for a nation as diverse as the United State of America, you are almost, be definition, bound to fail. And so I would err on the side of trying to create the market, create the transmission grid, give the States the right to oversee at the local level, and do it that way, instead of even with the best of intentions coming up with something almost out of the blue. I mean Mr. Wood disagrees with that. He is frowning. I should say out of the maroon, but then you wouldn't like it if I said that.

So in any event, before I turn it over to Mr. Boucher, I want to make—I asked I think in the first round of questions if everybody supported the concept of net metering, but I want to make sure that you all—you may not agree exactly how we are doing that metering in the bill, but the concept of net metering you support. Does the administration support that, Mr. Blake? Okay. Does the Commission support it?

Ms. BREATHITT. Yes.

Mr. BARTON. Okay. I don't know that TVA would have to have a position on net metering, but it would be nice to know if you do support it.

Mr. MCCULLOUGH. Yes, we do, Mr. Chairman.

Mr. BARTON. I thank you. The chairman recognizes Mr. Boucher for 5 minutes.

Mr. BOUCHER. Well, Mr. Chairman, at a minimum, I think we could do a net metering bill.

Mr. BARTON. That is a start, that is a start.

Mr. BOUCHER. Let me give the other members of the FERC, apart from the chairman, the opportunity to respond to the set of questions that I had propounded to the chairman earlier. And let me just briefly mention what these are. First of all, do you support a continuation of your merger review authority, and if so, why? Do you support the provisions in the legislation relating to incentive pricing as a way to encourage new transmission construction, or do you believe that there are other ways to accomplish the task of getting new transmission lines built?

With regard to Regional Transmission Organization membership, do you support any of the provisions in the legislation that relate to ways that membership will be required or do you believe in the alternative that your present processes and your present authorities are adequate to accomplish that task? And do you have any comments with regard to the uniform interconnection standards that are contained in the legislation? Or, in the alternative, do you think that you can go forward with current authority in order to promote a uniform interconnection standard? Ms. Breathitt, would you like to begin?

Ms. BREATHITT. Yes. I would like to address your question, No. 1, with respect to mergers. If I am not already on strong record, I would like to be placed on strong record now for asking the committee to please reconsider the language in the bill that would take away our merger authority. As I had mentioned earlier, we use a public interest standard. We are the only agency in merger review that uses that standard. Other agencies use a different standard, which is "no harm to competition," and I think it is real important

for one agency to have that standard for merger review. All mergers aren't created equal, and we look at the effect on rates, competition and the effect on regulation. I think that is very important for the public to have our agency as a place for that.

Mr. BOUCHER. While we are on the subject of merger review, let me ask Mr. Massey and Ms. Brownell if they have comments concerning that. Ms. Brownell?

Ms. BROWNELL. I never thought I would say this, having been on the other side of a merger when I worked in banking for a regulator, but I think we do need that authority. I think we look at it through a different screen, but I think it is important that we maintain discipline and focus and not use it as an opportunity for people to have a shopping spree to extort commitments that do not advantage either the merger, the shareholders or the consumers.

Mr. BOUCHER. Mr. Massey?

Mr. MASSEY. I agree with Commissioner Breathitt and Commissioner Brownell's comments. I think an important point is we have a very public and open process for determining mergers and all stakeholders get to come in and tell us what they think. That is important. It is not a closed process, and keeping it open is absolutely critical. And I agree that we have a broader standard than the anti-trust agencies use, and at this particularly critical time I would not recommend repealing our authority when we are promoting competitive markets. It could be that a merger would undercut the very competition that we are trying to facilitate.

Mr. BOUCHER. Thank you very much. Ms. Breathitt, would you like to talk to the RTO issue?

Ms. BREATHITT. Yes. Because of our open architecture language in Order 2000, we do have the ability to allow RTOs to change over time, and I would hate to see the committee limiting our flexibility to do that by having a very strict title. I liked your idea of addressing it and perhaps even mandating it, but keep the title simple to allow the flexibility that is going to happen over time.

Mr. BOUCHER. Okay. Ms. Brownell?

Ms. BROWNELL. I would agree with Commissioner Breathitt. I think it is very important that we encourage, mandate if you wish to do that, people to join RTOs, but because of the evolutionary nature and because we do have a different evaluation, companies should not control the process. They act in their own self-interest, as they should, and I applaud that. We have that larger self-interest to protect the consumers and the other stakeholders, and I think the provisions of this bill would limit that.

Mr. BOUCHER. Thank you. Mr. Massey?

Mr. MASSEY. I agree with my colleagues.

Mr. BOUCHER. Thank you, Mr. Massey. Thank you for that answer; that was terrific. You are an excellent witness. That is very much to the point.

Ms. Breathitt, Ms. Brownell and Mr. Massey, the question of incentive pricing.

Ms. BREATHITT. That one is tougher for me, because actually it was a controversial part of Order 2000, and we put that in there because it was a voluntary rule, and we wanted to have some carrots. It is in the reg text. Yes, it was controversial. But I do think that the Commission can use incentive pricing, but we need to do

it carefully, and, as Commissioner Brownell stated earlier, we shouldn't just be willy nilly using incentive pricing without a good public policy goal.

Mr. BOUCHER. Do you need any additional authority to do that?

Ms. BREATHITT. It is already in our reg text. We have made it part of the Federal regulations.

Mr. BOUCHER. So whatever is in the bill is really superfluous in that regard?

Ms. BREATHITT. I think so.

Mr. BOUCHER. Okay. Ms. Brownell, Mr. Massey, quickly, do you have a response?

Ms. BROWNELL. I don't think we need additional authority. I would reemphasize let us use this to incent innovation, incent efficiency, incent companies who are committed to opening markets. We have seen some interesting models in the UK where they have used performance-based and incentive-based ratemaking to reduce congestion through not only building new transmission but in fact adding innovative solutions to existing transmission. So I think we need to just not buy into the concept without addressing those very specific policy goals.

Mr. BOUCHER. Mr. Massey?

Mr. MASSEY. I don't think we should just throw money at transmission just for the sake of it. We ought to get some bang for our buck. If we are going to increase the incentives for transmission, we need more transmission to actually get built, and we need good performance in managing those transmission assets, and we ought to insist on it.

Mr. BOUCHER. Okay. Thank you all very much. Thank you, Mr. Chairman.

Mr. NORWOOD [presiding]. You are welcome. The Chair now recognizes Mr. Bryant, the gentleman from Tennessee, for 5 minutes for questions.

Mr. BRYANT. Thank you. Mr. McCullough, let me ask you a few more questions. The changes in TVA in this bill would result in the enactment of changes that are I think very dramatic to TVA. How do you think that TVA and TVA distributors would fare in a competitive wholesale market?

Mr. MCCULLOUGH. Well, Mr. Bryant, I believe that, first of all, has been taking steps, in terms of focusing on our business performance to ensure that we had a delivered price of power that was competitive, competitive with any region in the country, to ensure that our reliability when benchmarked against other utilities, the best in America, compares favorably. We have worked with our distributors to provide them with some flexibility in the requirements of their contracts. What does that—I had dinner last night with Herman Morris, the CEO at Memphis Light, Gas and Water. We have a proposal on the table that would enable any one of 158 power distributors to go to the market for 10 percent of their requirements with 24 months notice. They give us 24 months notice, they can buy 10 percent of what is now total requirements contract. With 36 months notice, they can buy all of their power in the open market from another supplier.

The way we are best preparing for competitive and open marketplace that TVA desires is by having the best practices in place in

the way we run our business. We believe without any doubt that TVA is competitive today and will be even more competitive in the future. We welcome competition and choice. It needs to be done in a manner that is consistent with the language that you and others have made sure is in tact in this 3406. The consensus title language welcomes competition and choice, enables TVA to compete with investor-owned utilities and other entities. Our distributors and the consumer can choose. We welcome that, and that is why we are very pleased that that language is in tact in H.R. 3406.

Mr. BRYANT. Now, you have testified that there will be language in the bill that would allow these 158 distributors to purchase their power elsewhere. Were a distributor to do this, how would their stranded cost be determined?

Mr. MCCULLOUGH. First of all, the language says that after 2000—after September 30 of 2007, there would be no potential stranded cost recovery for TVA. In the event that there are stranded costs—and we believe that we can wholesale. The fence should fall in both directions. In other words, once this language is enacted into law, the distributors can choose where to buy their power. TVA would be given the opportunity to wholesale, and I underline that word "wholesale" outside what is now the fenced-in area. If stranded costs become an issue, we would yield to FERC, and we have confidence in the wisdom of FERC to determine an equitable stranded cost recovery mechanism.

Mr. BRYANT. As I understand this new title, new generation to serve the Tennessee Valley load could be built by TVA but also by the distributors, by independent power producers and by other utilities. Is this correct, and why is it important that TVA be among those that would be allowed to build to meet its load?

Mr. MCCULLOUGH. You are correct. That language is in tact in H.R. 3406. TVA only asks the opportunity to compete on a level playing field with other investor-owned utilities, independent power producers, power marketers, as the Valley's economy continues to grow, and we hope it paces the rest of the Nation. We are in business to serve the Valley. We feel that we ought to have the right with the input from our power distributors. So TVA, unilaterally, would not make a decision on the need for new generation, but as the Valley's economy continues to grow, we feel it is only fair that TVA would have the right to choose, if necessary, to add new generation capacity to meet the growing demands of our Valley's economy.

Mr. BRYANT. Mr. Chairman, my voice is about to go, and I would yield back my time. Thank you.

Mr. NORWOOD. I thank the gentleman. Mr. Sawyer, you are recognized now for 5 minutes.

Mr. SAWYER. Thank you, Mr. Chairman. Let me return to a topic that we have touched on in the course of these discussions in a more specific way, and that is the need, as Commissioner Massey put it, to make decisions and get on with the business of building transmission capacity. The chairman has an approach in his bill that has a three-pronged test whether or not new transmission capacity is needed. First, if the States have not acted within 12 months, the FERC determines that the project will be used for

interstate commerce, and, third, the project is in the public interest.

Mine would trigger itself in a different way, but essentially come down to similar kinds of decisions. It would make a determination up front that there are transmission constraints and therefore a need and create an annual list of such locations and then proceed to permit that same, I suppose, arbitrary 12-month timeframe within which the States might act, after which the FERC would undertake this cut that the chairman would—I understandably prefer not to have to bring to his lips.

He suggested something the Department of Energy has talked about in terms of regional siting boards. I suppose that is a nice way around the whole States' rights question, but how they would work and how we would structure them it seems to me remains very much open. Could you, each of you, comment on the specifics of the siting procedures that are not only before us in the course of this week and suggest directions that we might go to reach a structure and a procedure that in the end would let us do what Commissioner Massey wanted to do—get on with it.

Mr. BLAKE. To start from the administration's perspective, I think, as you have articulated, is, first, circumscribing the authority very narrowly, using it only in the context where there is an identified national interest. And our view is that that would be something that we would identify in a larger national transmission study. Second, that you try to make this a regional decision, using presumably something like the RTO process, and that you would only be addressing those instances where, for a variety of reasons, the region can't act. I mean it would be a last step backstop.

Mr. SAWYER. Would the regions have a specific set of standards that we would determine nationally that each region would make separately or would they set separate standards? How do you——

Mr. BLAKE. Well, I think the national interest would be identified outside of the individual regions, and then the region, presumably, would have a number of different methods for addressing that national interest.

Mr. SAWYER. Chairman?

Mr. WOOD. There are really two things that happen in a transmission line. The first is the need. That is largely my experience has been, although not exclusively, been kind of not a big issue. The RTO engineers get an objective enough group of people that everybody acknowledges they are expert.

Mr. SAWYER. Well, if we look at Southern California——

Mr. WOOD. Well, you have got the need there. The issues then become——

Mr. SAWYER. But it was so difficult they couldn't get to it.

Mr. WOOD. And this is exactly why the RTO function is great. You had it on a boundary between PG&E and SoCal Edison. Well, SoCal Edison wanted to take care of the area within SoCal Edison. PG&E wanted to take care of the people within PG&E, but nobody really wants to build a bridge to the other one, because there is not a lot of money in it, there is not an incentive in it, your customers aren't perceived to get a real benefit from it. Too bad, actually they would have gotten a great benefit from it had it been worked out. But the same thing applies that even when you regionalize some-

thing to an RTO, you do get around the very parochial nature of each utility and each transmission company taking care of itself.

Mr. SAWYER. Commissioner?

Ms. BREATHITT. I think the provisions in the bill, as I have testified, take us in a very positive step forward. Now, I had advocated, though, for outright transmission siting authority for interstate, because one State could act within the 12 months, and another State may not. So then you have added a year to the process.

But the other point I would like to make is that the solution isn't always a transmission solution. It might be more inexpensive to build a power plant to solve congestion or it may be less expensive to build a gas pipeline to serve a constraint. So as Mr. Blake stated, there are several ways to cure a congestion problem besides just a new transmission.

Mr. WOOD. We would agree on that.

Ms. BROWNELL. Which I think speaks to the importance that an impartial analysis done by an RTO would speak to, because they would have no vested interest in either a transmission or a generation solution. Further, your suggestion, which I think DOE has already taken, to do an annual evaluation of transmission constraints and what they are costing us, because that is the point that we haven't really looked at, and is the invisible cost of, frankly, doing nothing with these markets.

Mr. MASSEY. And the third possible solution, in addition to a transmission solution or a generation solution, is a demand-side solution that lightens the load. And I think the RTO planning process can look at all three options, and on a regional basis, not just on a State-by-State basis, but on a regional basis. What is the best regional solution? It is not always transmission.

But when transmission is the best solution, we have got to get it sited, and I think the bill is a reasonable compromise respecting States' rights and the Federal responsibility to ensure that interstate markets work well. We have crossed the divide. We did that 6 years ago, and we said we wanted a market-based approach at the wholesale level. It seems to me it is now our responsibility to make sure those markets work well, and we can't do that without the necessary investment in transmission.

Mr. SAWYER. Thank you. Thank you, Mr. Chairman.

Mr. NORWOOD. I recognize myself now for 5 minutes, and Chairman Wood, if we could try to go back to where we left off.

Mr. WOOD. Yes, sir.

Mr. NORWOOD. The new FERC order that really singled out three companies changed the formula FERC used to calculate market power, not to mention that these companies don't have to commit an abuse, which drives me a little crazy. Your order includes generating capacity that is used to serve its retail customers and contracted commitments as far as generation and capacity. In short, if the order is intended for the wholesale market, retail customers shouldn't be affected by principle. The biggest problem with this test that you have set up is that it assumes that all the generation that a utility owns is available for sale in a whole sale market and thus included in the market power analysis.

Now, we talked about the fact that these companies could very easily be changed to cost-based rates for market-based rates and

that that would cost, for example, our major utility a lot of money for which much of that money is used to keep the retail rates down. Now, when you came to this decision, when you determined that we were going to do this, did FERC take time to have a study or look at how this would affect the rates of my constituents and Georgia Power customers? Did you do any work in that area?

Mr. WOOD. We did not do a cost/benefit study; no, sir.

Mr. NORWOOD. Did FERC then go ahead and analyze whether requiring Souther Company to post its cost for the world to see would reduce price competition and raise the prices at which Southern Company would have to buy power; again, another cost for my constituents? Did you do a study on that?

Mr. WOOD. We didn't do a study, but we actually are pretty familiar with the split savings approach. It has been one that the Commission has used for a while, which is how they put the cost of them producing the next increment, and then we split the difference between them and the customers' cost of buying the next increment, which is usually a number in between those——

Mr. NORWOOD. So you have a written detailed analysis of how you determined this wouldn't affect the ratepayer?

Mr. WOOD. No, but we have a written policy of how this process is done and was done for 80 years before the move to market-based rates——

Mr. NORWOOD. But you have made it so easy, you see, to take people out of market-based to cost-based now that it is a greater concern now. So we would like—you know, I would like to know how you are going to help me keep from raising the rates on consumers in Georgia?

Mr. WOOD. Well, I think the most helpful thing that can happen is—which we left specifically open, is that outside the area where they have a dominant market share, the utilities and their affiliates can sell into those markets in the neighboring States, the neighboring areas, and make sales into those markets in a competitive market that they don't have a dominant control, which is I think the goal that certainly this bill seems to be pointing toward.

Mr. NORWOOD. Well, do you—just tell me this: Do you agree forcing a company to post its cost of doing business for the world to see will end up then for that company causing them to pay more or less for power?

Mr. WOOD. I think their posting the costs for what it costs them to generate is what regulated companies do every time they go to retail rate cases. I think that data is certainly there for the Georgia regulators and the Alabama regulators to look at when they set the rates for the regulated retail side, and we are asking them to look at the same data.

Mr. NORWOOD. Well, I don't know that the Georgia regulators post it for the world to see. We have handled it pretty well. But you are talking about posting it for the whole damn world to see.

Mr. WOOD. Again, I think those are——

Mr. NORWOOD. And in a competitive market which you believe in that interferes with your ability to be competitive. Let us move to the next one because time is limited.

Mr. WOOD. Yes, sir.

Mr. NORWOOD. Tell me this: How many hundreds of millions of dollars might it cost Georgia Power's retail customer when large corporations want to interconnect to its transmission system and must, at least according to your November 20 order, be considered a network resource? Example: A cost that must be borne by retail customers again rather than the interconnecting company. How high do our rates got to go because of that November 20 order?

Mr. WOOD. Sir, I think in fact the interconnecting of more power plants in Georgia and in every other State will put downward pressure on the cost of power. The cost of power is probably 70 percent of a Georgia customers retail bill and to have that be derived not just from one company but from several companies competing against each other in Georgia and in the neighboring States will put downward pressure on the bills. That is the point of the whole initiative: to open up the grid so that competitive power plants compete against each other and drive those costs down. And there may be some costs to upgrade the transmission grid.

Mr. NORWOOD. What do you mean maybe?

Mr. WOOD. Well, there may be. If the transmission grid has to be added onto faster than other costs than the utilities rates are coming down, which they do, they depreciate over usually a 15-, 20-year life. If the cost of adding new plants is more than the cost of the old plant, depreciating down, and there is no growth of load, which is not true in that part of the country, there are a lot of things that have to be true before rates go up.

Mr. NORWOOD. Well, that is similar to the story we heard in Georgia about gas deregulation. It all makes sense when you sit there behind a desk and work it out, but in the end, many of these things you presume might happen, you think might happen in a free market, actually don't, and the problem here is when you are dealing with electricity in this country, energy in this country, we better be right. And you are sitting here telling me that you have put out a marketing order November 20 and nobody had time to do any studies, because we don't have to worry about Georgia because we are here in Washington worrying about the country.

Somebody has to worry about what the ratepayers have to pay at home, and I am being told by a lot of people, and it is amazing how many people who come from different walks of life in the utility market, that many of these things that you are doing are not going to work the way you hope and I hope they do too. They are going to increase the cost for our ratepayers. So did you do any studies? You said no already a couple of times.

Mr. WOOD. I have answered your question, but I think it is important to realize that monopolies generally do not favor competition, despite the very strong evidence in the wholesale gas industry that competition has resulted in tens of billions of dollars going back to customers. Your State has chosen to go to a retail gas experiment. That is a political decision. But the choice to open up wholesale markets is an economic decision, and I think the evidence is uniform.

Mr. NORWOOD. Well, it wasn't intended to be a political decision, and my time is up. It was intended to be an economic decision, the same as your decisions are intended to be economic decisions, and all I am saying is when you make those decisions and you affect

thousands and thousands of people, then we are concerned when you don't have a study to back—I need more information, because other smart people are saying you are not right. My time is up, don't forget where we were, I will be right back after this vote.

Mr. Chairman, Mr. Waxman would like to have the next 5 minutes.

Chairman TAUZIN. He is entitled to it, I believe.

Mr. NORWOOD. Mr. Waxman, you are recognized.

Mr. WAXMAN. Thank you very much, Mr. Chairman, both Mr. Chairmans. Mr. Wood, the policy you advocate regarding Regional Transmission Organizations is a bit different from the policy contained in H.R. 3406. You recommend that Congress authorize FERC to require RTOs where it would be in the public interest. H.R. 3406 mandates RTOs whether or not they are in the public interest. Is that an accurate distinction between your position and H.R. 3406?

Mr. WOOD. It is accurate, but it is not the source of my recommendations for amendment.

Mr. WAXMAN. Okay. I can see why you don't think there ought to be—I can see why you think there ought to be a public interest test. If Congress or FERC chose to force States into RTOs, that would be a pretty dramatic step. We don't yet know how much it would cost to establish RTOs, but it could cost tens or hundreds of millions of dollars. These costs could be borne by States and the private sector. Is that accurate?

Mr. WOOD. Yes, sir. All costs are borne by the customer, ultimately.

Mr. WAXMAN. Before mandating participation in RTOs, don't we have an obligation to ensure that RTOs make sense economically and from a policy perspective?

Mr. WOOD. Yes, sir. And for that reason we have agreed to do a region-by-region cost/benefit analysis for RTOs prior to implementing them.

Mr. WAXMAN. Establishing RTOs is a major Federal action, isn't it?

Mr. WOOD. I am not sure what those words mean, but I mean it certainly is an important thing that we would be doing.

Mr. WAXMAN. Okay. Whenever the Federal Government undertakes something important, like a major Federal action, it is required by law to examine the potential impacts on the environment. FERC should understand this, because when it issued Order 888, FERC analyzed the expected environmental impacts of increased competition. Unfortunately, we now know that FERC's analysis got it wrong.

A new study by the North American Commission on Environmental Cooperation demonstrated the links between electricity restructuring, increased demand for electricity and increased air pollution. In 1996, FERC projected that emissions from power generation were most likely to fall under competition. Instead air emissions increased and by more than FERC projected in its worse case scenario. The CEC study shows that FERC's worse case scenario underestimated the growth and demand from 1995 to 2000 by 4.6 percent. As a consequence, FERC underestimated emissions of nitrogen oxides by 4 percent and carbon dioxide by 8 percent.

Mr. Wood, since we agree there should be a sound policy basis for RTOs prior to their establishment, I have the following question for you: Would you commit today to updating FERC's projection of the environmental impact of increased competition prior to FERC's approval of any RTOs?

Mr. WOOD. I would not be able to agree to do that today.

Mr. WAXMAN. And why not?

Mr. WOOD. I have to look into whether actually NEPA would apply to what is an economic regulatory action. I read the report from the CEC that you have discussed, and I know these issues were reviewed on the court's original review of Order 888 and Order 2000, and I think the Commission was found to be within what it did appropriately the first time.

Mr. WAXMAN. Well, I am going to leave it to you to review and see whether it is required or not, along with your colleagues. But let me ask this of the members of the Commission. Chairman Barton in text in proposed H.R. 3406 to restructure the electric utility industry. Enron, a Texas-based energy company, has been lobbying for the policies in this bill for years. President Bush has endorsed Enron's model for electricity competition and his Department of Energy has testified they are generally in favor of this legislation. Reliant, another Texas-based energy company, has lobbied for the demand reduction program under Section 103 of this bill. And, Mr. Wood, you are a former Texas regulator, and you are working toward the goals of this bill through administrative action.

There is a lot of support for the policies we are considering today from companies and officials from Texas. However, the bulk of the bill before us does not appear to apply to Texas. Texas, one State in the continental U.S. that is not affected by the transmission provisions in this legislation. Historically, Texas has been treated separately from the rest of the U.S. under the logic that electricity does not flow across its borders. This logic is no longer true. Texas is now connected to other States. I would like to from the members of the Commission wouldn't it make sense to put Texas under the same rules that apply to Wisconsin, Georgia, California, Michigan and every other State in the continental U.S.? And wouldn't the rest of us in the U.S. feel more comfortable if they were also in there? Mr. Massey, do you want to comment on that?

Mr. MASSEY. Oh, I think it would probably make sense to do that, yes.

Mr. BARTON. Would the gentleman yield?

Mr. WAXMAN. Let us get the commissioners, and then I will be able to yield if I have any time.

Ms. BROWNELL. I think it would probably make sense. I would also add that there have been a number of advocates for competitive markets who come from other States. Certainly, Pennsylvania has a number of those advocates, and I am one of them.

Ms. BREATHITT. I think it would make sense for all interstate transmission to be part of the new grid that this bill is trying to create. I don't know what it would take to do that with respect to Texas, but I think that it should become part of the grid, just as this bill is asking public power to become.

Mr. WAXMAN. Mr. Wood?

Mr. WOOD. If I didn't think it would slow down the progress that was made in Texas for 5 years to have FERC catch up to where Texas is, I would probably not have a problem with it. But as one who committed the last 6 years of my professional career to advance the ideas that I am advancing here on the Federal level, I think putting Texas under Federal jurisdiction now would dramatically slow down the positive growth that has happened in my home State and would not support it.

Mr. NORWOOD. Thank you, Mr. Waxman. Mr. Chairman, you are recognized for 5 minutes.

Mr. BARTON. Well, I asked to be—I guess unanimous consent to be briefly——

Chairman TAUZIN. I do ask to be recognized. I yield quickly to my friend from Texas.

Mr. BARTON. I would just point out, in response to my good friend from California's question, you can make the argument that it would make a lot more sense to put the same State situation in the great State of California that we have in Texas where you have an intrastate system with more than ample supply and an interconnection network intrastate, through ERCOT, that disseminates power around the State in a very efficient and cost-effective fashion.

My good friend from California knows that California has an intrastate pipeline system for natural gas that is not subject to FERC jurisdiction——

Chairman TAUZIN. Maybe that ought to be.

Mr. BARTON. [continuing] and my recollection is that when Mr. Green of Texas offered an amendment to make it FERC jurisdictional, my good friend from California vehemently opposed that. So let us talk apples and apples and oranges and oranges, not apples and oranges. And with that, I would yield back.

Chairman TAUZIN. I thank my friend. I don't have a lot of time, Mr. Chairman, because I have not had a chance on the first round to ask a few questions. I am going to be very brief, but I am going to submit some questions to you and the other commissioners in writing.

I am deeply concerned, as a number of my colleagues on this panel are concerned, about the order issued on November 20. I am deeply concerned that it was issued without a process of public comment and that we are hearing an awful lot of about some very deleterious effects that it might have upon companies in our region and more importantly upon consumer rates and decisions those companies may make.

We are hearing, for example, that this new interim generation market power test you have adopted may well discourage new generation investment. It may expose our regions of the country to the same kind of problems California had, that it may indeed have the perverse incentive against longer-term investments and thus put us into a position where companies are making shorter-term and riskier transactions in order to avoid flunking your test. Some have said you put forward a test nobody can pass, and therefore it is met and designed simply to punish or force some companies into an RTO.

Now, I want those companies in an RTO; I think we all agree with that. I think getting the companies to join RTOs is a worthwhile goal. I share that with you and Commissioner Brownell, but I want to suggest to you that without having public comment, with all of these incredible assertions we are hearing about the effects of this order, that perhaps you might want to consider delaying the effectiveness of this order until you have had a chance to go on notice and accept public comments and examine some of these consequences.

I join the gentleman in the chair in being very concerned about the impact it may have on consumer rates in my part of the country. Rates are going down right now. There is no big crisis. And I question the wisdom of putting a big change like this into effect just perhaps to punish a few companies into joining RTOs when it may have some pretty serious effects. Now, I will let you respond, but I am going to ask some very specific questions on the record in writing since I am just about out of time, I think. Chairman Wood?

Mr. WOOD. Thank you, Chairman Tauzin. These orders, as the others, are subject to rehearing. Rehearing is the appropriate place for those companies and others to make comments to the Commission about these effects. The hub-and-spoke methodology, as well as this methodology, and really all the market-based rate issues, have always been dealt with on case-by-case adjudication and not by rulemaking. So it is not a departure from our process to do that, and we do have a process by which people can provide input on a rehearing, and I think those are actually due in the next couple of weeks for people to do so.

I have to say, as a practical matter, certainly in the South and in other parts of the country, there is a lot of progress toward RTO development or even independent system operators, which was the kind of precursor to RTOs. And our order specifically said if you are in an ISO or an RTO, that has a market monitoring, a market mitigation function that can identify on a surgical basis anti-market, anti-competitive behavior: that is the end goal we want. We don't want to have to live through California again, Mr. Chairman. We don't want the Congress to have to be put through that test, we don't want the consumers or the State, to be put through that test, and, actually, it is in a time when prices are low, when things are more calm and peaceful that we should be putting the trip wires that keep market power from hopping up and——

Chairman TAUZIN. I don't deny that. I don't deny that we ought to be encouraging the RTO transactions. I think we ought to encourage them, and I want to help you, but I am deeply concerned that the interim order you have put in place may have some very damaging effects on the market in the meantime. And you ought to hear some public comments. Whether you hear it in rehearing or whether you delay the implementation until you have had a chance to ferret all these questions out, we ought to have some confidence in that. None of us want to go home and say that on our watch our Federal authority made a significant change without a lot of public comment, that caused a dislocation of rates and generation investment in our communities when in fact we are very

deeply concerned about what we saw in California and it repeating itself in other parts of the country.

I had a blackout in Louisiana, believe it or not. Energy-rich State like Louisiana, we had one a few years ago. I can't afford the risk of having that happen in my State, on my watch, and I would urge you to be extraordinarily careful about receiving the public comment and input you need before you move forward.

Mr. WOOD. We will, Mr. Chairman, and the comments on that were extended at parties' request until early January. So people do have time to get that in.

Mr. NORWOOD. I thank the Chairman. I would like to close our hearing by announcing that there will be a notice published that will go to markup next Wednesday when we are back in town. And I would like to close, Chairman Wood, by just telling you that I have a lot of other questions that I am deeply sorry that we couldn't air them here, that I would like to get very specific answers to, and for you to note that we have noted that by joining an RTO, a utility can make all these bad things go away with the market order. And that suggests, perhaps, just suggests to an untrained eye that FERC's November 20 order might have been punitive like heads on stakes and stuff like that.

Punishing companies who have not yet complied with Order 2000, an order that I know you know was voluntary, but it is really, in our view, the customers of Georgia Power who will be harmed of public power in Georgia, a State that is very proud of what and how we have been doing things. And I hope that hasn't escaped the Commission.

There is a lot I would like to tell you about deer hunting. You know, this thing being in the woods and campfires and all that kind of stuff, heads on stakes, it is dealing with deer hunting but unexperienced deer hunters can run into a lot of problems in the woods. Sometimes you are real anxious, sometimes you have got a itchy finger, sometimes you are staring out there real, real hard looking for that buck-only day and everything looks like it has antlers on it. And sometimes you shoot the wrong deer and you kill that doe and you are not supposed to, and they will come along and take your license and sometimes you are so anxious as an experienced hunter that you actually wound a buck, and they are real dangerous when they get wounded. Those antlers and hooves will chew you up.

So we are glad you are here, and we hope we are going to be able to work this out, but you better pick on a lot more companies than three if you want to do any picking, particularly when one of them is out of the Southeast. So with that, I will adjourn this hearing until tomorrow where we will resume the hearing tomorrow. Meeting adjourned.

[Whereupon, at 5:29 p.m., the hearing was recessed until Thursday, December 13, 2001.]

[Additional material submitted for the record follows:]

FEDERAL ENERGY REGULATORY COMMISSION
OFFICE OF THE CHAIRMAN
February 13, 2002

The Honorable W.J. "BILLY" TAUZIN
Chairman
Committee on Energy and Commerce
U.S. House of Representatives
Washington, D.C. 20515-6115

DEAR MR. CHAIRMAN: I am pleased to reply to the questions in your letter of January 14, 2002 on recent Commission actions regarding regional transmission organizations (RTOs) and market based rate authorizations. For your convenience, I've repeated your question before providing an answer.

Question (1) Please describe any analyses the Commission has undertaken of the proper scope, configuration and market rules for RTOs and of the costs and benefits to consumers in each State of proposed RTOs and alternatives.

Following our week-long public hearings on RTO issues in October, 2001, the Commission committed to our state commissioner colleagues and others that we would update and disaggregate the cost-benefit studies that were done in 1999 for Order No. 2000. On November 1, 2001, the Commission contracted with ICF to perform the analyses. The base case the contractor uses in these analyses characterizes current utility dispatch, planning, and other industry conditions important for analyzing the economic impacts of an RTO proposal. The base case also reflects the "no action" alternative, *i.e.,* status quo implementation of Order No. 888 by the Commission. The analyses include use of a modeling framework that builds scenarios needed to characterize and study the proposed RTO initiatives and produce economic impacts for use in economic cost and benefit analysis. We are consulting with a regionally diverse, interested and knowledgeable group of state Commissioners on the details of the models to make the results as accurate and meaningful as possible. Our contractor expects to deliver the study later this month.

Question (2) As you know the Louisiana Public Service Commission issued a show cause order to Entergy and others about why they should be allowed to join an RTO. What have you done to resolve the concerns of state regulators in Louisiana and other states about impacts on retail customers from utility participation in RTOs?

The Commission has worked extensively to identify and begin to solve the concerns of state regulators about impacts on retail customers from utility participation in RTOs in all the states. Specifically, in brief, we have:

- Held five RTO national outreach workshops in March and April 2000;
- Held state-specific sessions during the Commission's October 2001 RTO Week;
- Undertaken a cost-benefit analysis of RTOs in response to state requests;
- Begun using state-FERC panel discussions to identify and address RTO issues of mutual concern;
- Expanded collaboration through the National Association of Regulatory Utility Commissioners (NARUC);
- Invited and received extensive state commissioners' on-the-record comments on a number of regional RTO concerns.

The details on each of these below, though somewhat lengthy, show we continue to work with state regulators to resolve state concerns about RTO impacts on retail customers.

RTO National Outreach. In Order No. 2000, the Commission said that it would undertake a collaborative process, one in which Commission staff would be fully engaged with transmission owners, public and non-public utilities, as well as state officials and affected interest groups, to actively work toward the voluntary development of RTOs. That process began in March and April 2000 with five national workshops, including one in Kansas City, Missouri and another in College Park, Georgia.

State Sessions During RTO Week. To continue our dialogue, we held workshops on RTOs in October 2001 and devoted various sessions to state issues. We learned about the retail-customer concerns states have related to cost-shifting, RTO startup costs, and independence.

Cost-Benefit Analysis. As discussed in response to question No. 1, during those October meetings, the states asked the Commission to do a cost-benefit analysis for each RTO region (and perhaps for each state) to determine the effect on retail customers. We began that work right away and expect to have some results by late February 2002.

State-FERC Panel Discussions. Based on the discussion at the October 2001 workshops, the Commission decided to move on two parallel tracks to finalize RTO issues. The first track is addressing geographic scope and governance aspects of RTO proposals after we have consulted with state commissions. The second track

for resolving RTO issues is a proceeding addressing transmission tariff and market design rules for public utilities, including RTOs. This will address the issues needed for organizations to accomplish the characteristics and functions in Order No. 2000.

The Commission has begun regional state-FERC panel discussions on RTO and market design issues to provide a more systematic foundation for obtaining state input. The Commission has already had state-FERC panel discussions with state commissioners from the Midwest and Northeast and plans discussion with Southeast Commissioners on February 15. Transcripts of these discussions are placed in the appropriate dockets. The Commission also has created a new Division of State Relations within the Office of External Affairs.

Expanded Collaboration Through NARUC. The Commission also has reached out to the states through the National Association of Regulatory Utility Commissioners. The Commission held two of three sessions on issues of mutual concern during NARUC's upcoming winter meetings in Washington, D.C. On February 10, we discussed whether wholesale and retail transmission service should be under the same rates, terms and conditions. On February 11, we discussed how regulators can assure an adequate capacity reserve for regional energy markets. On February 14, we will be cosponsoring with the Department of Energy a demand response conference.

Finally, with respect to the specific concerns of the Louisiana Public Service Commission and other Southeast state commissions, I want to assure you of my commitment to carefully consider their views on these important matters.

Question (3) How does the new "supply margin" market power test in the Commission's order of November 20 differ from the established "hub-and-spoke" test for market power? Did the Commission conduct any study or analysis before issuing the new market power test to determine what percentage of vertically-integrated public utilities, if any, would be able to pass the test? Would any such utility be able to pass the new test?

The "hub-and-spoke" test for generation market power computes an applicant's market share of installed capacity and uncommitted capacity in a particular market. A separate analysis is required for each utility that is directly interconnected with the applicant (relevant market). The analysis compares the installed capacity of the applicant to the sum of the installed capacity of the applicant, all utilities directly interconnected with the applicant, and all utilities directly interconnected with the relevant market. A similar analysis is performed for uncommitted capacity. While the Commission did not employ a bright line test, it used a benchmark that a seller did not have generation market power if, on balance, a seller has a market share of 20 percent or less in each relevant market.

The "supply margin assessment" (SMA) builds on and improves the established hub-and-spoke analysis in two ways. First, in determining the geographic market, the SMA considers transmission constraints that may prevent a seller from delivering its power to a particular buyer. Thus, the SMA can more accurately determine what supply can reach buyers to compete with the applicant. Second, in determining the size that triggers generation market power concerns, the SMA establishes a threshold based on whether an applicant is pivotal in the market, *i.e.,* whether at least some of the applicant's capacity must be used to meet the market's peak demand. An applicant will be pivotal if its capacity exceeds the market's surplus of capacity above peak demand—that is, the market's supply margin. Thus, an applicant will fail the SMA screen if the amount of its capacity exceeds the market's supply margin. By contrast, under the hub-and-spoke method, an applicant would pass the screen if its market share were less than 20 percent, even if its capacity were pivotal. Effectively, the supply margin threshold identifies whether the applicant is a must-run supplier needed to meet peak load in a market. Thus, the supply margin is sensitive to the potential for the applicant to successfully withhold supplies in the market in order to raise prices.

The Commission's staff examined numerous options for addressing generation market power, and a copy of a staff paper on the topic was made available to the public on the Commission's website following the September 26, 2001 Commission meeting. Because the test is an objective one, intended to apply on a nondiscriminatory basis to all applicants, the Commission did not conduct a study or analysis to determine which of the current 1200 power market certificate holders would be able to pass the test. Whether a particular vertically-integrated public utility would be able to pass the SMA screen will depend on the facts of a particular case. A vertically-integrated public utility will pass the test if its capacity is not pivotal in relevant markets; *i.e.,* the control area that it operates or adjacent control areas.

Question (4) What findings, circumstances, or emergency conditions warranted the Commission's apparently sudden change of policy in the November 20 order? What

specific findings of abuse of market power did the Commission make prior to issuing the order?

The November 20 order was issued in response to continuing concerns raised by intervenors in market-based rate cases (including the dockets involving AEP, Entergy and Southern) that the hub-and-spoke analysis does not adequately assess generation market power and, in particular, that it does not consider transmission constraints. The issue was identified and discussed in dissenting and concurring opinions by three of the four current FERC Commissioners in a number of orders issued last summer. *See, e.g., Sierra Pacific Power Company and Nevada Power Company,* 96 FERC ¶61,050 (2001); *Huntington Beach Development, L.L.C.,* 96 FERC ¶61,212 (2001). In addition, the issue was discussed by the Commission at its September 26, 2001 public meeting. As noted in response to question (3), a staff paper discussing options for addressing market power was made available to the public following the September 26, 2001 public meeting.

In the November 20 order, the Commission stated that it "has concluded that, because of significant structural changes and corporate realignments that have occurred and continue to occur in the electric industry, our hub-and-spoke analysis no longer adequately protects customers against generation market power in all circumstances. The hub-and-spoke analysis worked reasonably well for almost a decade when the markets were essentially vertical monopolies trading on the margin and retail loads were only partially exposed to the market. Since that time markets have changed and expanded. While we intend to undertake a generic review of markets and market power in general, we conclude that in the interim a more appropriate test should be applied to ensure that customers are protected against market power in generation. Accordingly, we have developed a Supply Margin Assessment (SMA) screen to be used pending completion of a generic rulemaking proceeding." 97 FERC ¶61,219 at 61,969.

Question (5) What analysis did the Commission conduct to determine whether revocation of market based rate authority could result in increased retail rates for consumers in states served by the affected utilities?

In its November 20 order, the Commission did not revoke the market-based rate authority of the affected utilities. The Commission established cost-based mitigation only for prospective spot market sales (*i.e.,* less than 24 hours) within the affected utilities' control areas. The Commission subsequently deferred implementing price mitigation measures pending further proceedings.

The Commission did not conduct an analysis to determine whether revocation of market-based rate authority could result in *increased* retail rates. The Commission stated in the November 20 order that the hub-and-spoke analysis no longer adequately protects customers against generation market power In all circumstances. Therefore, it concluded that the interim SMA screen "should be applied to ensure that customers are protected against market power in generation." 97 FERC ¶61,219 at 61,969. Preventing the exercise of such market power benefits the retail customers of utilities that would otherwise have to pay excessive prices for purchases from sellers with market power.

Question (6) Would a public utility that is a member of a Commission-approved RTO be exempt from the November 20 order? If so, given that no public utility is now a member of a Commission-approved RTO, was the order intended to penalize RTO applicants who disagree with the Commission regarding the appropriate scope or configuration of an RTO?

The November 20 order explains that all sales, including bilateral sales, into an ISO or RTO *with Commission-approved market monitoring and mitigation* will be exempt from the SMA and, instead, will be governed by the specific thresholds and mitigation provisions approved for the particular markets. 97 FERC ¶61,219 at 61,970. As a result, a public utility that is a member of a Commission-approved RTO would be exempt from the November 20 order to the extent that the RTO has Commission-approved market monitoring and mitigation. The Commission-approved market monitoring and mitigation should prevent the exercise of generation market power in the relevant markets, thus justifying the exemption from the SMA. The order was not intended to penalize RTO applicants who disagree with the Commission regarding the appropriate scope or configuration of an RTO. Since the November 20 SMA order, FERC has approved the MISO RTO, which currently supports electric service to more than 8 million customers in 15 states across the Midwest and Canada.

Question (7) The District of Columbia Circuit Court of Appeals recently held that RTO participation under the Commission's Order No. 2000 is voluntary. Do you believe that indirect means of "encouraging" RTO participation, such as revocation of market based rate authority, are consistent with the voluntary and flexible approach of Order No. 2000?

The Commission's actions are not inconsistent with Order No. 2000 and, indeed, were taken to fulfill our responsibilities under the FPA to ensure just and reasonable rates. Because an RTO with approved market monitoring and market power mitigation reduces sellers' ability to exercise market power within the RTO region, and because an RTO ensures nondiscriminatory transmission access and increases market efficiency, it is appropriate to encourage all utilities to join an RTO and is not necessary to require those utilities in an RTO to comply with an additional market power test such as the SMA. For utilities that do not sell in areas that have market power mitigation in place, however, the Commission has the responsibility under the FPA to ensure that market power cannot be exercised before it authorizes market-based rates. Because the hub-and-spoke test no longer assures lack of market power in generation, the Commission replaced it.

Question (8) Is it appropriate for the Commission to adopt an entirely new market power test without first holding a rulemaking proceeding with opportunity for comment? In the absence of a new rule developed out of an open process, is it appropriate for the Commission to revoke a utility's market-based rate authority without a hearing for that utility?

This question concerns legal issues that have been raised by a number of entities in requests for rehearing of the November 20 order. Since these are pending before the Commission now, under the Administrative Procedure Act and the Commission's ex parte rule, it is inappropriate for me to respond to these questions at this time.

Question (9) We understand that the Commission has issued a stay with respect to portions of the November 20 order, and we are pleased that the Commission will convene a technical conference where affected parties will have the opportunity to address the consequences of the order. Does the Commission also plan to engage in an open notice-and-comment rulemaking process before adopting a new market power test? If not, will each affected company be afforded an opportunity for a hearing before its market-based rate authority is revoked under a new policy?

This question also concerns issues that have been raised by a number of entities in requests for rehearing of the November 20 order. Thus, I cannot comment on the merits at this time.

Question (10) Our understanding is that the Commission has not delayed the implementation of that portion of the November 20 order that requires all three companies to treat unaffiliated entities seeking to interconnect as competing network resources and to post optimum areas for the location of prospective generating facilities on their websites. Does the Commission intend to provide the affected parties an opportunity for a hearing or comment before this requirement takes effect?

It is correct that the Commission has not delayed the implementation of that portion of the November 20 order that requires all three companies to treat unaffiliated entities seeking to interconnect as competing network resources and to post optimum areas for the location of prospective generating facilities on their web sites. A number of entities have raised issues regarding this aspect of the November 20 order in their requests for rehearing. The full Commission will decide at some future time how to address these questions.

Question (11) Numerous utilities have expended a great deal of time, money and effort to develop RTO applications that meet the RTO standards under Order No. 2000. Our understanding is that Order No. 2000 established a voluntary and flexible approach to RTO formation and specifically contemplated a variety of corporate structures for RTOs, including independent transmission companies and independent system operators. Despite this, the Commission has not approved a single RTO, including RTOs that were previously conditionally approved by the Commission. Does this mean tile Commission has taken a narrower or different course on RTO policy in departure from the voluntary and flexible approach of Order No. 2000?

No, the Commission had not changed course on RTO policy.

On December 19, 2001 the Commission granted RTO status to the Midwest ISO (97 FERC ¶61,326). Although the Commission directed the Midwest ISO to make certain additional filings, the new RTO received the authority it needed to begin to operate immediately. The Midwest RTO began commercial operations and security coordination in December 2001 and began providing service under a single tariff in February 2002.

Question (12) Our understanding is that the Alliance RTO was conditionally approved several times prior to the order of December 19, in which the Alliance must now consider merging with the Mid-West ISO (MISO). Please explain why the Commission has apparently changed course with respect to the Alliance and how (if at all) this change is consistent with the voluntary and flexible approach of Order No. 2000.

As stated in the Commission's December 19 order:

Our earlier finding regarding the adequacy of the scope of the Alliance RTO relied, in part, on implementation of the [Inter-RTO Coordination Agreement (IRCA)]... which was intended to provide the basis for a seamless market in the territories served by the Midwest ISO and the Alliance RTO. However, since the Commission issued its order approving the Settlement and its July 12 Order approving Alliance RTO's scope, the confidence of the Commission and participating state commissions in the IRCA's ability to resolve seams issues has eroded. Specifically... the Midwest ISO and Alliance Companies filed status reports which indicate that the IRCA implementation has not progressed as expected... We have also taken additional continents from the various state commissions in the Midwest, and they overwhelmingly prefer a single Midwest RTO and Midwest ISO as the surviving RTO. Another change affecting our ruling is International Transmission's election to withdraw from the Alliance RTO, thereby shrinking the Alliance RTO and concomitantly diminishing its scope. As a result, we can no longer conclude that the proposed Alliance RTO has sufficient scope consistent with the factors identified in Order No. 2000... In sum, the Alliance RTO has not achieved the necessary close coordination that was called for to achieve Order No. 2000's characteristics, and in particular, scope, that it could not achieve on its own. 97 FERC ¶61,327 at 62,529-530

The December 19 order is pending rehearing, so I cannot comment further.

Question (13) The Commission states in its December 19 Alliance order that "our action should not be construed to prejudge other types of RTOs in other parts of the country, including a structure in which a for-profit transmission company could be an umbrella RTO." If the Commission is able to conditionally approve, and then later reject, an RTO proposal developed at great expense on the requirements of Order No. 2000, what assurances do RTO applicants in other regions have that "rules of the road" will not change and prevent them from forming RTOs that satisfy the requirements of Order No. 2000?

The rules of the road have not changed. The Commission is committed to choosing regulatory approaches that foster competitive markets whenever possible and assure reliable service at a reasonable price. This question also raises issues that are the subject of rehearing and I cannot discuss it further.

I hope this information is helpful. If I can be of further assistance in this or any other Commission matter, please let me know.

Best regards,

PAT WOOD, III
Chairman

FEDERAL ENERGY REGULATORY COMMMISSION
OFFICE OF THE CHAIRMAN
February 25, 2002

The Honorable JOE BARTON
Chairman, Subcommittee on Energy and Air Quality
Committee on Energy and Commerce
U.S. House of Representatives
Washington, D.C. 20515-6115

DEAR MR. CHAIRMAN: Thank you for your letter of February 15, 2002. Your letter cites a study issued by the Commission's staff in December 2001 on electric transmission constraints. The study identified numerous transmission constraints across the United States and stated that increases in transmission infrastructure investment would benefit customers by decreasing costs caused by congestion on existing lines. You ask several questions about this study and the provisions in section 401 of H.R. 3406 on transmission pricing methods that could encourage expansion of the transmission grid. Below are my answers to your questions.

Question 1: The Study states that Commission staff have "identified a number of significant transmission constraints that increase costs to customers." It identifies 16 specific constraints across the Northeast, the Eastern Interconnection, and the West. It estimates that these constraints cost consumers more than $1 billion total the summers of 2000 and 2001 combined. Please explain further why these constraints have resulted in higher electricity costs for consumers.

Answer: Transmission constraints hamper the efficient operation of markets and increase customer costs by restricting the ability of suppliers to deliver less expensive energy into constrained "load pockets". This means that when customer demand inside the "load pocket" exceeds the capability of the transmission lines to deliver power into the area, the transmission limit may, depending on the availability of cheaper generation outside the load pocket, shut out additional cheaper generation and force local demand to be met by more expensive generation inside the con-

straint area. Thus, transmission constraints force customers to buy more expensive energy because they cannot get cheaper energy over the transmission grid.

Question 2: The Study also set forth an objective to "[r]ecognize that even with the high estimated cost of transmission investment . . . the overall savings in energy could significantly benefit customers." The Study apparently achieved this objective, finding that the benefits to consumers from increased transmission investment (in terms of the delivered price for electricity) are "potentially quite large." Is substantial new investment in transmission capacity necessary to eliminate or reduce the costly constraints identified in the Study?

Answer: In many cases, yes. The transmission constraints that were studied limit significant amounts of low-cost power imports for many hours in each year. In most of those cases, area reliability and total power costs would be significantly improved by construction of additional bulk transmission lines.

For other constraints, however, transmission expansion is one option to eliminate transmission constraints, but not necessarily the only one. Other options include building new generation, including distributed generation, and energy conservation within the constrained area. The Study noted that substantial additional investment in new transmission capacity could be made with only a small impact on customer bills, and can produce significant cost savings in the delivered price of energy into the load pocket. Moreover, all alternatives are problematic. For example, constructing new generation necessitates finding an acceptable location for the plant, air pollution offsets, and additional fuel supplies. A regional planning process, such as the one contemplated in the Commission's Order No. 2000 on regional transmission organizations, is needed to determine which alternatives are both feasible and cost effective.

Question 3: How will the Commission's transmission rate policies, including incentive and performance-based rate treatments, help ensure that the transmission industry attracts sufficient investment to alleviate transmission constraints on a priority basis?

Answer: A longstanding principle of the Commission's ratemaking is that rates must allow an opportunity for the utility to earn a return on invested capital commensurate with the returns earned by other companies facing similar risks. This principle is intended to ensure that utilities can attract the capital they need to build infrastructure. The Commission has authorized additional incentives for transmission investments in certain circumstances. Last year, for example, the Commission authorized a range of premiums on equity returns and accelerated depreciation for transmission expansions completed by certain deadlines in the Western United States. The goal of these rate incentives was to encourage urgently-needed infrastructure expansions in response to the severe electric energy shortages then facing California and other areas in the West. As another example, the Commission has authorized a range of rate incentives for regional transmission organizations, since these organizations can bring greater efficiencies to power markets and benefits to customers. I am willing to consider similar incentives or other ratemaking methods whenever necessary to ensure that utilities and independent merchant transmission builders can obtain the capital they need to support timely and adequate expansion of our Nation's infrastructure.

Question 4: Particularly given the Study's findings regarding the benefits of increased transmission investment, section 401's provisions for incentive and performance-based transmission rates seem to be reasonable and in the public interest. Surprisingly, opponents of transmission rate reform have claimed that section 401 would require the Commission to set transmission rates at "unjust and unreasonable" levels. In your opinion, would section 401 repeal, undermine, or otherwise be inconsistent with the just and reasonable standard of the Federal Power Act ("FPA")? In other words, would section 401 permit or require the Commission to charge rates that are unjust or unreasonable under sections 205 or 206 of the FPA (either the plain text of those sections or as they have been historically construed by the courts)?

Answer: No. Section 401 of H.R. 3406 would require the Commission to adopt by rule:

> . . . transmission pricing policies and standards for promoting the expansion and improvement of interstate transmission networks through incentive-based and performance-based rate treatments and other means the Commission deems necessary or appropriate to ensure reliability of the electric system, to support interstate wholesale markets for electric power, and expand transmission capacity needed to sustain the growth of wholesale competition.

The policies and standards established under section 401 would be required to accomplish certain goals, such as "promot[ing] economically efficient enlargement of transmission networks," "provid[ing] a return on equity that causes needed invest-

ment in transmission facilities to be made," "promot[ing] the voluntary participation in and formation of regional transmission organizations," "reduc[ing] congestion on transmission networks," and "allow[ing] for accelerated depreciation for transmission equipment and facilities." Section 401 requires that all transmission rates approved after the effective date of the new rules must comply with, among other things, "the requirement of sections 205 and 206, that all rates, charges, terms and conditions be just and reasonable and not unduly discriminatory."

These provisions are consistent with the existing provisions of the FPA as applied by the Commission and interpreted by the courts. We interpret the provisions of section 401 as clarifying authority that the Commission already has under the FPA, in its discretion, to allow different types of non-traditional rate treatments to meet our regulatory goals, so long as those rate treatments meet the statutory requirement that rates be just and reasonable and not unduly discriminatory or preferential. As noted above in response to Question 3, the Commission already has taken certain actions similar to those specified in section 401. In addition, the Supreme Court has held that "rate-making agencies are not bound to the service of any single regulatory formula; they are permitted, unless their statutory authority otherwise plainly indicates, 'to make the pragmatic adjustments which may be called for by particular circumstances.'" Permian Basin Area Rate Cases, 390 U.S. 747, 776 (1968) (citing FPC v. Natural Gas Pipeline Co., 315 U.S. 575, 586 (1942)). The Commission may set rates to achieve relevant regulatory purposes, and may do so by including non-cost incentives to encourage behavior in the public interest. Mobil Oil Corp. v. FPC, 417 U.S. 283, 316-17. Encouraging future supply is an appropriate factor in determining a just and reasonable rate and adequate protection of customers. *Permian Basin,* 390 U.S. at 796, 815. Accordingly, section 401 of H.R. 3406 would *not* permit or require the Commission to allow utilities to charge unjust or unreasonable rates under sections 205 or 206, and would provide us continued discretion to allow non-traditional rate treatments as appropriate.

Question 5: While the Commission already has broad authority to set the boundaries of the "zone of reasonableness" under the just and reasonable standard, do you agree that section 401 would provide useful clarification and direction to the Commission to tailor transmission rates to the policy goals of eliminating transmission constraints, increasing efficiency of wholesale power markets, and reducing the overall cost of delivered power for consumers? Would section 401 help prevent non-productive challenges to the Commission's legal authority to design rate treatments appropriate to meet these policy goals?

Answer: Ensuring development of adequate energy infrastructure is vitally important to all energy customers. One of my goals as Chairman of the Commission is to encourage the full exercise of our statutory authority to promote such development. While I believe the FPA's existing provisions allow the Commission to take the types of actions addressed in section 401, some participants in the industry may disagree. Section 401 could help reduce or forestall legal challenges on these issues. Thus, I support the provisions of section 401.

If I can be of further assistance in this or anything else, please call me.

Best regards,

PAT WOOD, III
Chairman

THE DEPUTY SECRETARY OF ENERGY
WASHINGTON, DC 20585
January 31, 2002

The Honorable HENRY A. WAXMAN
U.S. House of Representatives
2204 Rayburn House Office Building
Washington, DC 20515

DEAR REPRESENTATIVE WAXMAN: I am writing in response to your questions during my testimony before the House Energy and Air Quality Subcommittee on December 12, 2001, as well as your letter dated January 25, 2002, regarding discussions with electric utilities, other industry sectors, and environmental groups about the new source review (NSR) program.

I have held the following meetings regarding the NSR program. A list of the meeting attendees is enclosed.

- July 10, 2001: Natural Resources Defense Council
- July 18, 2001: Sinclair Oil Company
- July 23, 2001: Electric Reliability Coordinating Council
- July 25, 2001: The Coal-Based Generation Stakeholder's Group

- August 28, 2001: WEST Associates
- August 29, 2001: Wisconsin Energy Corporation
- September 10, 2001: Edison Electric Institute
- November 28, 2001: Air Quality Coalition

Please let me know if I can be of any further assistance on this, or any other, matter.

Sincerely,

FRANCIS S. BLAKE

Enclosure

ATTENDEES AT MEETINGS/DISCUSSIONS BETWEEN DEPUTY SECRETARY OF ENERGY FRANCIS S. BLAKE AND REPRESENTATIVES FROM ELECTRIC UTILITIES, OTHER INDUSTRY SECTORS, AND ENVIRONMENTAL GROUPS REGARDING: THE NEW SOURCE REVIEW PROGRAM

July 10, 2001, Natural Resources Defense Council

David Hawkins, Natural Resources Defense Council.

July 18, 2001, Sinclair Oil Company

Clint Ensign, Klane Forsgren, Albert Knoll, Dick Wilson, Lee Lampton, Richard Meeks, and Jim McCarthy.

July 23, 2001, Electric Reliability Coordinating Council

Glenn McCullough, TVA, Anthony J. "Tony" Alexander, FirstEnergy, Dwight Evans, Southern Company, Bill Coley, Duke Power, Richard M. "Dick" Hayslip, Haley Reeves Barbour, ERCC, Boyden Gray, ERCC, Marc Racicot, ERCC, Jeanette Pablo, TVA, Michael Dowling, FirstEnergy, Karl Moor, Southern Company, David Mitchell, Duke Energy, Henry Nickel, Hunton & Williams, Terry Grauman, Hunton & Williams, and Rene Eastman, Salt River Project.

July 25, 2001, The Coal-Based Generaton Stakeholder's Group

Irl Englehardt, Peabody Energy, Tom Kuhn, Edison Electric Institute, Fred Palmer, Peabody Energy, James Roberts, RAG American Coal, Tom Altmeyer, National Mining Association, Tony Kavanaugh, American Electric Power, and Quin Shea, Edison Electric Institute.

August 28, 2001, West Associates

Robbie Aiken, Pinnacle West Capital Corporation, Renee Eastman, The Salt River Project, Don Elliott, Paul, Hastings, Janofsky & Walker, Dave Lock, Platte River Power Authority, C.V. Mathai, Pinnacle West Capital Corporation, Gloria Quinn, Southern California Edison, David Steele, Strategic Issue Management Group, and Linda Stuntz, representing PacifiCorp.

August 29, 2001, Wisconsin Energy Corporation

Richard Abdoo, Darnell Demasters, Larry Bruniel, and Pat Quinn.

September 10, 2001, Edison Electric Institute

Gerard M. Andreson, DTE Energy, William A. Coley, Duke Energy, E. Linn Draper, American Electric Power, Dwight H. Evans, Southern Company, Robert A. Fenech, Nuclear, Consumers Energy, Thomas R. Kuhn, Edison Electric Institute, Gary L. Rainwater, AmerenCIPS, James E. Rogers, Jr., Cinergy Corporation, Skiles W. Boyd, Detroit Edison, Ray Harry, Southern Company, Mary D. Kenkel, Cinergy Corporation, John D. Kinsman, Edison Electric Institute, Susan LaBombard, Ameren Services, Alfonse S. Mannato, Jr., Edison Electric Institute, Quinlan J. Shea, III, Edison Electric Institute, Daniel V. Steen, FirstEnergy Corporation, William F. Tyndall, Cinergy, and Steven Colovas, American Continental Group.

November 28, 2001, Air Quality Coalition

Kevin O'Donovan, Larisa Dobriansky, Red Cavaney, API, Tom Kuhn, Edison Electric Institute, Tom Altmeyer, National Mining Association, Henson Moore, American Forest Paper Association, Rose Sanders, American Chemistry Council, Mark Whittendon, National Association of Manufacturers, and James Schultz, American Iron/Steel Institute.

FEDERAL ENERGY REGULATORY COMMISSION
OFFICE OF THE CHAIRMAN
February 28, 2002

The Honorable JOE BARTON, *Chairman*
Subcommittee on Energy and Air Quality
Committee on Energy and Commerce
U.S. House of Representatives
Washington, D.C. 20515-6115

DEAR CHAIRMAN BARTON: This is in response to Congressman Waxman's request for information asked at your subcommittee hearing on February 13, 2002. He asked me to provide a list of my contacts with Enron officials during my terms as a commissioner at the Federal Energy Regulatory Commission (FERC) and at the Public Utility Commission of Texas (PUCT).

As the enclosed chronology details, I first met Ken Lay on May 29, 1996, when I was invited to present an update on Texas telecommunications and electric utility regulation to the members of the Governor's Business Council, an advisory group of Texas business executives that Mr. Lay had chaired since then-Governor Ann Richards formed the council in the early 1990's.

The enclosed chronology reflects my best recollection of all contacts I had with Enron officials based in part on calendars I have maintained since January 1996. 1 do not have any records prior to January 1996. 1 have not maintained phone logs during this period. Despite this, I believe that the contacts in the enclosed chronology represent all contacts with Mr. Lay and other officials, with the exception of Steve Kean, with whom I may have talked by phone two or three times over the seven-year period. From my records, the first occurrence of a meeting with Steve Kean is in 1998, but I feel certain we had been introduced sometime prior to that date.

In addition, the enclosed chronology does not list any meetings with non-executive Enron staff or outside attorneys, nor does it reflect contacts I may have had at legislative hearings, PUC Open Meetings, public conferences or public speeches. The enclosed chronology does not reflect several meetings I had with former Enron de Mexico President Max Yzaguirre in Texas during May, 2001 to discuss the duties of a PUCT Commissioner.

Finally, as you prefaced your oral request with a reference to letters Mr. Lay was reported to have written endorsing my nomination to both my current and prior positions, the letter that actually played a role in getting me an interview with then Governor Bush in early 1995 has not been in the public record. In 1991-1993 I worked as a legal counsel to FERC Commissioner Jerry J. Langdon, a Democrat from Midland, Texas who had known Governor Bush for many years. Martin L. Allday, also from Midland, was Chairman of FERC under President George H.W. Bush, including during the time I worked for Commissioner Langdon. Shortly after the 1994 Texas gubernatorial election, these two men wrote a letter recommending me to Governor-elect Bush for the open PUCT position. After his inauguration, Governor Bush called me in for an interview for the position on January 27, 1995. During my interview, I observed the enclosed letter from Chairman Allday and Commissioner Langdon on his desk. He offered me the position after our interview. I accepted it, and following my confirmation by the Texas Senate on February 22, 1995, was sworn in by Governor Bush and joined the PUCT the following day.

I trust this information satisfies the request. Please contact me if I can provide any further information.

Best regards,

PAT WOOD, III
Chairman

Enclosures

Cc: The Honorable Rick Boucher

CONTACTS Between Pat Wood, III and Enron Officials during Wood's terms at Texas PUC and FERC (February 23, 1995 to date)

DATE	Enron Official	Contact Type	Subject Matter of Content
5/29/96	Ken Lay	Wood's presentation at Governor's Business Council (100+ Texas business leaders; chaired by Lay)	Wood updated Council on telecom and electric utility regulation
3/3/97	Jeff Skilling	Wood presentation at DOE-sponsored fact-finding trip for German utility officials held at Enron's offices	Wood presentation to Germans on Texas regulation. Visit to "trading floor"
~3/97	Ken Lay	Wood phone call to Lay	Wood seeking Enron support for Gov.'s utility restructuring bill (unsuccessful)
1/15/98	Steve Kean	Kean visit to Wood office	(No specific notes of visit. Based on date, I expect discussion related to upcoming activities of Legislative study committee on electric restructuring)
11/29/99	Ken Lay	Wood's presentation at Governor's Business Council	Wood updated Council on telecom and electric utility regulation
1/24/01	Ken Lay	Wood phone call to Lay	Wood's concern about erratic shift of Enron policy on key Texas market design issue. Lay's congratulations on Wood's rumored FCC appointment (no response from Wood since Wood's 10/6/00 and 1/16/01 conversations with Clay Johnson regarding FERC position were not public).
~5/2/01	Steve Kean	Meeting in Washington DC	Update on Congressional activity relating to electric restructuring
9/20/01	Stan Horton Mark Frevert Steve Kean	Visit to Wood office with Jerry Halvorsen of INGAA and other pipeline company officials	Pipeline industry preparations following 9/11 attacks. (Thank you note from Frevert received on 9/26/01).
10/3-4/01	Ken Lay	Wood presentation at US Energy Policy conference in Arlington, VA	Wood at speakers' table with Lay, Barton, Bingaman and Schlesinger on 10/3; Wood presentation to conference on 10/4
11/8/01	Ken Lay	Lay phone call to Wood (not reached)	From Email of phone message, it appears to have been a call to inform of proposed merger with Dynegy

November 18, 1994

Mr. George Bush
5950 Berkshire, Suite 990
Dallas, Texas 75225

Re: Public Utility Commission
Pat Wood

Dear ~~George~~ Governor:

We know you are besieged with requests from many sides by various individuals and/or interests for appointments to the many areas of government that you will be overseeing as Governor of our state.

Yesterday the undersigned were visiting about a lawyer named Pat Wood who is currently the legal assistant to Barry Williamson at the Railroad Commission. Pat Wood was a legal assistant in Langdon's office, who, as you know, served with Allday on the Federal Energy Regulatory Commission in Washington during the time your dad was President. He is a Port Arthur native and an Aggie (that's OK) who subsequently got his law degree from Harvard University.

We both understand that there are appointments made for political reasons, but there are also appointments that need to be made based on expertise and ability. A Public Utility Commissioner is one of the latter. It is a critical appointment to the well-being of Texas. Experience in fair regulation, with no ax to grind, and protection of the consumer, coupled with a need to encourage the regulated industries, is truly needed at this vital Commission.

Because we both have seen first-hand (in spades) the ability, integrity, energy and dedication to service that Pat Wood exemplifies, we recommend that you consider appointing him to the above Commission. You simply could not do much better from our way of thinking.

We understand that Barry Williamson is aware of Pat Wood's interest in the indicated position. We both know from personal experience that when you lose a trusted helper it hurts, but in fairness you must let that helper progress when the opportunity arises. We believe Barry would hurt, but be willing.

Enclosed you will find a resume. If you want to discuss Pat Wood with either or both of us, feel free to call.

Yours truly,

Martin L. Allday
600 Congress Avenue, Suite 1500
Austin, Texas 78701
512/495-6354

Jerry J. Langdon
700 Milam Street, 13th Floor
Houston, Texas 77002
713/546-3765

THE ELECTRIC SUPPLY AND TRANSMISSION ACT OF 2001

THURSDAY, DECEMBER 13, 2001

HOUSE OF REPRESENTATIVES,
COMMITTEE ON ENERGY AND COMMERCE,
SUBCOMMITTEE ON ENERGY AND AIR QUALITY,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:30 a.m., in room 2123, Rayburn House Office Building, Hon. Joe Barton (chairman) presiding.

Members present: Representatives Barton, Largent, Whitfield, Ganske, Norwood, Shimkus, Fossella, Bryant, Walden, Tauzin (ex officio), Boucher, Sawyer, Wynn, John, Waxman, Markey, Gordon, McCarthy, and Dingell (ex officio).

Staff present: Jason Bentley, majority counsel; Sean Cunningham, majority counsel; Andy Black, policy coordinator; Sue Sheridan, minority counsel; and Eric Kessler, minority professional staff.

Mr. BARTON. The subcommittee will come to order. Today is a continuation of 2 days of hearings on the Electric Supply and Transmission Act of 2001. These are legislative hearings on a pending bill, H.R. 3406, preparing to go to markup next week.

Today we have two panels. Our first panel is our executive branch witnesses. We have the Honorable Isaac Hunt, who is the Commissioner of the Securities and Exchange Commission; and we have the Honorable Sandra Hochstetter, who is Chairman of the Arkansas Public Service Commission. She is appearing on behalf of the National Association of Regulatory Utility Commissioners, better known as NARUC.

Lady and gentleman, welcome. Your statement is in the record in its entirety. We are going to recognize you, Commissioner Hunt, to elaborate on your statement for 6 minutes; and then we will recognize the Chairwoman Hochstetter to elaborate on her statement. Welcome to the subcommittee.

STATEMENTS OF HON. ISAAC C. HUNT, JR., COMMISSIONER, SECURITIES AND EXCHANGE COMMISSION; AND HON. SANDRA L. HOCHSTETTER, CHAIRMAN, ARKANSAS PUBLIC SERVICE COMMISSION, ON BEHALF OF NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS

Mr. HUNT. Thank you, Mr. Chairman, Ranking Member Boucher, and members of the subcommittee. I am Commissioner Isaac C. Hunt, Jr., of the U.S. Securities and Exchange Commission. I am pleased to have this opportunity to testify before you on behalf of

the Commission about H.R. 3406 and the SEC's continuing support for repeal of the Public Utility Holding Company Act of 1935.

The SEC continues to support efforts to appeal the 1935 Act and replace it with legislation that preserves certain important consumer protections. In considering repeal, it is useful to review both the history that led Congress to enact the Act in 1935 and the changes that have occurred in the electric industry since then.

During the first quarter of the last century misuse of the holding company structure led to serious problems in the electric and gas industry. Abuses arose, including inadequate disclosure of the financial position, and earning power of holding companies, unsound accounting practices, excessive debt issuances, and abusive affiliate transactions.

The 1935 Act was enacted to address these problems. In the years following the passage of the Act the SEC worked to reorganize and simplify existing public utility companies in order to eliminate the problems that Congress identified.

By the early 1980's the SEC concluded that the 1935 Act had accomplished its basic purpose and that many aspects of it had become redundant with other Federal and State regulation.

In addition, changes in the accounting profession and in the investment banking industry had provided investors and consumers with a range of protections unforeseen in 1935. Because of these changes the SEC unanimously recommended that Congress repeal the 1935 Act based on its conclusion that it was no longer necessary to prevent the recurrence of the abuses that led to the Act's enactment.

For a number of reasons, including the potential for abuse through the use of a multi-State holding company structure, related concerns about consumer protection, and the lack of a consensus for change, repeal legislation was not enacted during the early 1980's.

Because of continuing changes in the industry, however, the SEC continued to look at ways to administer the statute more flexibly. In response to continuing changes in the utility industry during the early 1990's, then Chairman Arthur Levitt directed the SEC staff in 1994 to undertake a study of the 1935 Act that culminated in a June 1995 report.

That report again recommended repeal of the 1935 Act, or amendment of the Act to give the SEC broad exemptive authority to administer the Act.

The June 1995 report also outlined and recommended that the Commission adopt a number of administrative initiatives to streamline regulation under the Act. The SEC has implemented many of these initiatives.

The utility industry has continued to undergo rapid change since publication of the report. Congress facilitated some of these changes. Specifically the Energy Policy Act of 1992 added statutory exemptions to the 1935 Act, which allow holding companies to own exempt wholesale generators and foreign utility companies and allow registered holding companies to engage in a wide range of telecommunication activities.

Based on the findings in 1995, as well as the continuing pace of change in the industry, the SEC continues to recommend that Congress appeal the 1935 Act, subject to appropriate safeguards.

Repeal of the Act is not, however, a magical solution to the current energy problems in the United States. While it can be viewed as a part of a needed response, repeal will not directly affect the supply of electricity due to the fact that the Energy Policy Act, as I just mentioned, removed restrictions under the Act for investment and generation facilities.

Repeal of the Act would, however, remove provisions that prohibit utility companies from owning utilities in different parts of the country, and generally prevent non-utility businesses from acquiring utilities in more than one State.

If the 1935 Act were repealed, the greatest impacts would probably be the continuing consolidation of the utility industry, as well as the entry of new companies into the utility business.

Repeal of the Act would also eliminate any impediments that exist to other regulators' attempts to modernize regulation of the utility industry. For example, the FERC recently implemented new regulations designed to create independent regionally operated transmission grids.

As a result of FERC's new regulations, many utilities will cede operating control, and in some cases actual ownership, of their transmission facilities, to newly created entities.

The status of both the new entities that will control these systems, and the status of the utility companies that will own stakes in the new entities, raise a number of issues under the 1935 Act.

Most notably, it has been asserted that the limits the Act places on the other business activities of a utility holding company will create obstacles for non-utility companies to invest in or operate these new transmission entities.

The SEC believes that it has the necessary authority under the Act to deal with the issues created by FERC's restructuring without impeding that restructuring. Nevertheless, repeal of the Act would effectively resolve these issues.

In conclusion, let me emphasize that the SEC takes seriously its duties to administer faithfully the letter and spirit of the 1935 Act and is committed to promoting the fairness, liquidity, and efficiency of the United States securities markets.

By supporting conditional repeal of the 1935 Act, the SEC hopes to reduce unnecessary regulatory burdens on America's energy industry while providing adequate protections for energy consumers. Mr. Chairman and Members, I would be pleased to answer your questions.

[The prepared statement of Hon. Isaac C. Hunt, Jr. follows:]

PREPARED STATEMENT OF HON. ISAAC C. HUNT, JR., COMMISSIONER, U.S. SECURITIES AND EXCHANGE COMMISSION

Chairman Barton, Ranking Member Boucher, and Members of the Subcommittee: I am pleased to have this opportunity to testify before you on behalf of the Securities and Exchange Commission ("SEC") regarding H.R. 3406 and the SEC's continuing support for repeal of the Public Utility Holding Company Act of 1935 ("PUHCA" or "1935 Act"). In particular, because much of the regulation required by PUHCA is either duplicative of that done by other regulators or unnecessary in the current environment, the SEC continues to support repeal of PUHCA. H.R. 3406 would accomplish the goal of eliminating duplicative and unnecessary regulation. As

the SEC has testified in the past, however, we continue to believe that repeal should be accomplished in a manner that also preserves important protections for consumers of utility companies in multistate holding company systems.

I. INTRODUCTION

To understand the SEC's position on repeal of PUHCA, it is useful to review both the history that led Congress to enact PUHCA in 1935 and the changes that have occurred in the electric industry since then. During the first quarter of the last century, misuse of the holding company structure led to serious problems in the electric and gas industry. These abuses included inadequate disclosure of the financial position and earning power of holding companies, unsound accounting practices, excessive debt issuances and abusive affiliate transactions. The 1935 Act was enacted to address these problems.[1] The Act also placed restrictions on the geographic scope of holding company systems and limited holding companies to activities related to their gas or electric businesses. Because of its role in addressing issues involving securities and financings, the SEC was charged with administering the Act. In the years following the passage of the 1935 Act, the SEC worked to reorganize and simplify existing public utility holding companies in order to eliminate abuses.

By the early 1980s, however, many aspects of the 1935 Act regulation had become redundant: state regulation had expanded and strengthened since 1935, and the SEC had enhanced its regulation of all issuers of securities, including public utility holding companies. Changes in the accounting profession and the investment banking industry also had provided investors and consumers with a range of protections unforeseen in 1935. The SEC therefore concluded that the 1935 Act had accomplished its basic purpose and that many of its remaining provisions were either duplicative or were no longer necessary to prevent the recurrence of the abuses that had led to the Act's enactment. The SEC thus unanimously recommended that Congress repeal the Act.[2]

For a number of reasons—including the potential for abuse through the use of a multistate holding company structure, related concerns about consumer protection, and the lack of a consensus for change—repeal legislation was not enacted during the early 1980s. Because of continuing change in the industry, however, the SEC continued to look at ways to administer the statute more flexibly.

In response to continuing changes in the utility industry during the early 1990s, and the accelerated pace of those changes, in 1994, then-Chairman Arthur Levitt directed the SEC's Division of Investment Management to undertake a study, under the guidance of then-Commissioner Richard Y. Roberts, to examine the continued vitality of the 1935 Act. The study was undertaken as a result of the developments noted above and the SEC's continuing need to respond flexibly in the administration of the 1935 Act. The purpose of the study was to identify unnecessary and duplicative regulation, and at the same time to identify those features of the statute that remain appropriate in the regulation of the contemporary electric and gas industries.[3]

The SEC staff worked with representatives of the utility industry, consumer groups, trade associations, investment banks, rating agencies, economists, state, local and federal regulators, and other interested parties during the course of the study. In June 1995, a report of the findings made during the study ("Report") was issued. The staff's Report outlined the history of the 1935 Act, described the then-current state of the utility industry as well as the changes that were taking place in the industry, and again recommended repeal of the 1935 Act. The Report also

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[1] *See* 1935 Act section 1(b), 15 U.S.C. § 79a(b).

[2] *See Public Utility Holding Company Act Amendments: Hearings on S. 1869, S. 1870 and S. 1871 Before the Subcomm. On Securities of the Senate Comm. On Banking, Housing, and Urban Affairs,* 97th Cong., 2d Sess. 359-421 (statement of SEC).

[3] The study focused primarily on registered holding company systems. There were, at the time of the study, 19 such systems. The 1935 Act was enacted to address problems arising from multistate operations, and reflects a general presumption that intrastate holding companies and certain other types of holding companies, which the 1935 Act exempts and which now number 119, are adequately regulated by local authorities. Despite their small number, registered holding companies account for a significant portion of the energy utility resources in this country. As of September 30, 2001, the 27 registered holding systems (which included 35 registered holding companies) owned 133 electric and gas utility subsidiaries, with operations in 44 states, and in excess of 2500 nonutility subsidiaries. In financial terms, as of September 31, 2001, the 27 registered holding company systems owned more than $417 billion of investor-owned electric and gas utility assets and received in excess of $173 billion in operating revenues. The 27 registered systems represent over 40% of the assets and revenues of the U.S. investor-owned electric utility industry and almost 50% of all electric utility customers in the United States.

outlined and recommended that the Commission adopt a number of administrative initiatives to streamline regulation under the Act.

Since the report was published, the utility industry in the United States has continued to undergo rapid change. Some of these changes have been facilitated by Congress. Specifically, as a result of recently-created statutory exemptions, anyone, including registered and exempt holding companies, is now free to own exempt wholesale generators and foreign utilities and to engage in a wide range of telecommunication activities.[4] In addition, the SEC has implemented many of the administrative initiatives that were recommended in the Report.[5]

III. REPEAL OF PUHCA

Based on the findings in the Report as well as the continuing pace of change in the utility industry, the SEC continues to recommend that Congress repeal the 1935 Act subject to appropriate safeguards.[6] As the Report stated, regulation under the 1935 Act that affects the ability of holding company systems to issue securities, acquire other utilities, and acquire nonutility businesses is largely redundant in view of other existing regulation and controls imposed by the market.[7] Repealing the Act is not, however, a magic solution to the current problems facing the U.S. utility industry. PUHCA repeal can be viewed as part of the needed response to the current energy problems facing the country—notably, the Administration's recent report on energy policy includes a recommendation that PUHCA be repealed.[8] But repeal of the Act will not, for example, have any direct effect on the supply of electricity in

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[4] Sections 32 and 33 of the Act, which were added to it by the Energy Policy Act of 1992, permit, subject to certain conditions, the ownership of exempt wholesale generators and foreign utility companies. The impact of section 32 on the electricity industry is discussed in more detail below. Section 34, which was added by the Telecommunications Act of 1996, permits holding companies to acquire and retain interests in companies engaged in a broad range of telecommunications activities.

[5] The Report recommended rule amendments to broaden exemptions for routine financings by subsidiaries of registered holding companies (*see* Holding Co. Act Release No. 26312 (June 20, 1995), 60 FR 33640 (June 28, 1995)) and to provide a new exemption for the acquisition of interests in companies that engage in energy-related and gas-related activities (see Holding Co. Act Release No. 26667 (Feb. 14, 1997), 62 FR 7900 (Feb. 20, 1997) (adopting Rule 58)). In addition, the Report recommended and the SEC has implemented changes in the administration of the Act that would permit a "shelf" approach for approval of financing transactions. For example, during calendar year 2000, all eleven of the new registered holding companies received multi-year financing authorizations that included a wide range of debt and equity securities. The Report further recommended a more liberal interpretation of the Act's integration requirements which has been carried out in our merger orders. The Report also recommended an increased focus upon auditing regulated companies and assisting state and local regulators in obtaining access to books, records and accounts. Six state public utility commissions participated in the last three audits of the books and records of registered holding companies.

[6] We do, however, have a concern about coupling PUHCA repeal with provisions that would provide unique regulatory benefits to small groups of companies under other statutes that the Commission administers. Section 125 of H.R. 3406 raises this concern. Section 125 appears to address a unique set of circumstances that give rise to questions about the status of an issuer as an "investment company" under the Investment Company Act of 1940. The Investment Company Act already provides the Commission with significant flexibility to deal with status issues. We therefore see no reason for legislation to deal with such issues. More broadly, we are prepared to work with any utility holding companies currently relying on the exemption from the definition of "investment company" provided by section 3(c)(8) of the Investment Company Act if repeal of PUHCA leads to questions about their status under the Investment Company Act.

[7] As we have testified previously, however, there is a continuing need to protect consumers. Although deregulation is changing the way utilities operate in some states, electric and gas utilities have historically functioned as monopolies whose rates are regulated by state authorities. Some regulators subject these rates to greater scrutiny than others. There is a continuing risk that a monopoly, if left unguarded, could charge higher rates and use the additional funds to subsidize affiliated businesses in order to boost its competitive position in other markets. Thus, so long as electric and gas utilities continue to function as monopolies, the need to protect against this type of cross-subsidization will remain. In view of the sophistication of contemporary securities regulation, and analysis by the public and private sectors, the best means of guarding against cross-subsidization is likely to be audits of books and records and federal oversight of affiliate transactions. The SEC therefore continues to recommend the enactment of legislation to provide necessary authority to the FERC and the state public utility commissions relating to affiliate transactions, audits and access to books and records, for the continued protection of utility consumers. More broadly, repeal of the 1935 Act may be accomplished either separately or as part of a more comprehensive package of energy reform legislation. The SEC does not have a preference as to whether the Act is repealed on a stand-alone basis or as part of broader, energy-related legislation.

[8] *See* National Energy Policy: Report of the National Energy Policy Development Group at 5-12 (May 2001) (recommending the reform of "outdated federal electricity laws, such as the Public Utility Holding Company Act").

the United States. The Act does not, for example, currently place significant restrictions on the construction of new generation facilities. As part of the Energy Policy Act, Congress amended the Act in 1992 to remove most restrictions on the ability of registered and exempt holding companies (as well as nonutility companies) to build, acquire and own generating facilities anywhere in the United States. These types of facilities—exempt wholesale generators or "EWGs"—are not considered to be electric utility companies under PUHCA, and, in fact, are exempt from all provisions of PUHCA. The only limitation that remains under PUHCA is one imposed by Congress on registered holding companies—namely, that a registered company may not finance its EWG investments in a way that may "have a substantial adverse impact on the financial integrity of the registered holding company system."[9] In short, the Energy Policy Act removed restrictions on the ability of registered and exempt holding companies to build, acquire and own generating facilities anywhere in the United States. As a result, a number of registered holding companies now have large subsidiaries that own generating facilities nationwide. Numerous other companies not subject to the Act have also entered the generation business.[10]

Instead, repeal of the Act would eliminate regulatory restrictions that prohibit utility holding companies from owning utilities in different parts of the country and that prevent nonutility businesses from acquiring regulated utilities. In particular, repeal of the restrictions on geographic scope and other businesses would remove the impediments created by the Act to capital flowing into the industry from sources outside the existing utility industry. Repeal would thus likely have the greatest impact on both the continuing consolidation of the utility business as well as the entry of new companies into the utility business.

Repeal of the Act would also eliminate any impediments that exist to other regulators' attempts to modernize regulation of the utility industry. For example, during the past year, questions have arisen about how the Act will impact the ability of the Federal Energy Regulatory Commission ("FERC") to implement its plans to restructure the control of transmission facilities in the United States.[11] Specifically, in order to "ensure that electricity consumers pay the lowest price possible for reliable service," the FERC recently implemented new regulations designed to create "independent regionally operated transmission grids" that are meant to "enhance the benefits of competitive electricity markets."[12] As a result of FERC's new regulations, many utilities will cede operating control—and in some cases, actual ownership—of their transmission facilities to newly-created entities. The status of these entities, as well as the status of utility systems or other companies that invest in them, raise a number of issues under the Act. Most prominently, it has been asserted that the limits the Act places on the other businesses in which a utility holding company can engage will create obstacles for nonutility companies that may wish to invest in or operate these new transmission entities.

The SEC believes it has the necessary authority under the Act to deal with the issues created by the FERC's restructuring without impeding that restructuring. Nonetheless, repeal of the Act would effectively resolve these issues.

The SEC takes seriously its duties to administer faithfully the letter and spirit of the 1935 Act and is committed to promoting the fairness, liquidity, and efficiency of the United States securities markets. By supporting conditional repeal of the 1935 Act, the SEC hopes to reduce unnecessary regulatory burdens on America's energy industry while providing adequate protections for energy consumers.

Mr. BARTON. Thank you, Commissioner.

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[9] While no Commission approval is required for the acquisition of an EWG as a result of the Energy Policy Act, Commission approval is required, for example, before a registered holding company can issue securities to finance the acquisition of, or guarantee securities issued by, an EWG. Under the Energy Policy Act, Congress directed the SEC to adopt rules with respect to registered holding companies' EWG investments. Pursuant to these requirements, in 1993 the SEC adopted rules 53 and 54 to protect consumers and investors from any substantial adverse effect associated with investments in EWGs. Rule 53 created a partial safe harbor for EWG financings. Rule 53 describes circumstances in which the issue or sale of a security for purposes of financing the acquisition of an EWG, or the guarantee of a security of an EWG, will be deemed not to have a substantial adverse impact on the financial integrity of the system. For transactions outside the Rule 53 safe harbor, a registered holding company must obtain SEC approval of the amount it wishes to invest in EWGs. The standards that the SEC uses in assessing applications of this type are laid out in Rule 53(c).

[10] *See, e.g.,* National Energy Policy: Report of the National Energy Policy Development Group at 5-11 (May 2001) (noting that "[m]ost new electricity generation is being built not by regulated utilities, but by independent power producers").

[11] *See* FERC Order 2000, "Regional Transmission Organizations,' 65 FR 810 (Jan. 6, 2000) (codified at 18 C.F.R. § 35.34).

[12] Order 2000, 65 FR at 811.

We would now like to hear from the Chairwoman of the Arkansas Public Services Commission, the Honorable Sandra Hochstetter. Your statement is in the record, and we would ask that you elaborate for 6 minutes.

STATEMENT OF HON. SANDRA L. HOCHSTETTER

Ms. HOCHSTETTER. That you, Mr. Chairman, and members of the subcommittee. I am here today on behalf of NARUC, and we would like to commend you for your tireless work on the issue of electric restructuring.

We would also like to thank you for including NARUC in the discussions and process since you have been chairman of this subcommittee. Our testimony here today is a mixture of concerns, as well as compliments.

To begin with, NARUC would like to say that we are pleased that you did not include a section that would expand FERC jurisdiction to include unbundled retail transmission service in H.R. 3406.

We do believe that the issue of transmission jurisdiction is now properly before the Supreme Court. Accordingly, we recommend that Congress allow the Court to continue to rule on transmission jurisdiction issues prior to taking any legislative action.

Second, we would like to thank you for Section 605 with respect to retail competition. However, we do feel that you could go a bit further to clarify that a State can determine not to implement retail competition.

The issue of whether or not that it makes economic sense for any particular State to adopt retail competition is clearly a unique State-specific factual inquiry that should depend upon a quantitative analysis of cost versus benefit.

We appreciate the difficulties with divergent points of view that you have confronted to get the legislation to this point. However, we feel like we must express significant concern with H.R. 3406 as it is currently drafted.

First, as to interconnection standards. While NARUC supports national technical power quality standards adopted by an appropriate technical standards organization, we must oppose the provisions found in Section 101 which provides for Federal preemption of distribution of interconnection terms, conditions, costs, and rates.

FERC should properly focus on transmission interconnection standards, and not distribution. We consider this to be a safety and reliability issue, as well as a generation supply and potential cost shifting issue, and therefore State and local officials, and retail customers, should be responsible for working out those details.

As to net metering, while NARUC appreciates the efforts of this committee to permit States to establish additional requirements to those net metering standards promulgated by FERC, we must express concern and oppose the federally preemptive provisions found in Section 102.

Once again that metering is a retail jurisdiction issue, subject to State jurisdiction. With respect to Section 103, we support demand management programs, but believe that retail demand reduction

programs should be developed by the States under traditional State jurisdiction over retail services.

Once again, these are retail consumer programs. We do feel, however, that Congress could be helpful in the demand reduction area by doing things in the following areas. Congress can promote energy efficiency programs through the use of increased funding, tax credits, in the setting of increasingly more efficient national building codes and standards for motors, lighting, and appliances.

And additionally Congress should continue to provide funding for energy efficiency and conservation for low and moderate income consumers, as these are appropriate Federal programs.

On the issue of a regional transmission organization, NARUC believes that an RTO formation can provide benefits to the market and to all consumers provided that the policies that establish RTOs will enhance the Federal-State partnership, and provide for truly independent RTO governance and operation with appropriate Federal and State oversight.

The Arkansas Commission, as a matter of fact, has been one of the strongest State Commission supporters of FERC's efforts to facilitate the formation of RTOs. However, we remain concerned that an appropriate role for State Regulators in both RTO creation and operation has not been formalized.

In addition, there are certain important transmission pricing issues that need to be resolved. H.R. 3406 does not advance State participation in any aspect of RTO governance or decisionmaking.

The mandatory participation provisions of H.R. 3406 also fail to recognize and take into consideration that currently under State laws utilities are generally required to obtain State Commission approval to participate in RTOs if the membership would require transfer of assets into the RTO.

In addition, we believe that Congress should require FERC to recognize States' interests in actively reviewing questions of RTO governance. These areas would include the development and revision of market rules, reliability in planning, access to RTO market monitoring information, and development with Federal authorities of market power mitigation programs.

With respect to transmission reliability, NARUC has consistently agreed that reliability should be addressed in any Federal electricity legislation. However, we believe that while this needs to take place on a Federal level, the law should also preserve the authority of the States to set more rigorous standards when deemed to be in the public interest.

Congress should expressly include in the legislation a savings clause that would protect existing State authority to ensure reliable transition service, as well as a regional advisory role for the State.

State officials ultimately will be held accountable by the public when the lights fail to stay on. So, because of this responsibility, we believe that we need to act effectively to ensure uninterrupted electricity service.

With respect to siting authority, we would strongly oppose any legislative provisions that contemplate Federal siting authority. While the Arkansas Commission certainly understands the basis for the recommendation by some parties that transmission siting

authority should be vested in FERC, we would recommend that the States, utilizing where appropriate regional mechanisms, continue to have primary siting authority.

And then if such regional approaches once employed prove inadequate or fail, then the question of FERC's role can certainly be revisited at that time. In conclusion, we would like to thank you again for our ability to participate in this process.

Unfortunately, we can't support the bill as it is currently drafted. We don't believe that a compelling case has been made for Federal preemption of State retail authority. Congress can and should do much to help the wholesale market and focus on those issues.

But it should stop short of usurping State regulatory jurisdiction over retail matters. Thank you again, and I would be happy to answer any questions that you may have.

[The statement of Hon. Sandra L. Hochstetter follows:]

PREPARED STATEMENT OF HON. SANDRA L. HOCHSTETTER, CHAIRMAN, ARKANSAS PUBLIC SERVICE COMMISSION ON BEHALF OF THE NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS

Mr. Chairman and Members of the Subcommittee: My name is Sandra L. Hochstetter. I am the Chairman of the Arkansas Public Service Commission. I am here today on behalf of the National Association of Regulatory Utility Commissioners, commonly known as NARUC. I greatly appreciate the opportunity to appear before the House Energy and Commerce Subcommittee on Energy and Air Quality and I respectfully request that NARUC's written statement be included in today's hearing record as if fully read.

NARUC is a quasi-governmental, nonprofit organization founded in 1889. Its membership includes the State public utility commissions for all States and territories. NARUC's mission is to serve the public interest by improving the quality and effectiveness of public utility regulation. NARUC's members regulate the retail rates and services of electric, gas, water and telephone utilities. We have the obligation under State law to ensure the establishment and maintenance of such energy utility services as may be required by the public convenience and necessity, and to ensure that such services are provided at rates and conditions that are just, reasonable and nondiscriminatory for all consumers.

Mr. Chairman, NARUC commends you for your tireless work on the issue of electric restructuring. We would also like to thank you and your staff for including NARUC in the discussions and process since you have been Chairman of this Subcommittee. You have been willing to speak to our members on numerous occasions and have been consistently willing to listen to our concerns.

NARUC is pleased that you did not include a section that would expand FERC jurisdiction to include unbundled retail transmission service in H.R. 3406. We believe that the issue of transmission jurisdiction is now properly before the Supreme Court. Accordingly, NARUC continues to recommend that Congress allow the Court to rule on transmission jurisdiction issues prior to taking any legislative action. We would also like to take this opportunity to thank you for section 605, which clarifies that this legislation will not require a State to implement retail competition or require the unbundling of retail transmission.

Mr. Chairman, while we do appreciate the difficulties with divergent points of view you have confronted to get this legislation to this point, NARUC must express our significant concerns with H.R. 3406 as it is currently drafted. NARUC is troubled by the great extent to which the bill intrudes into areas now regulated by the States.

I would now like to share NARUC's views on specific provisions found in H.R. 3406. In some instances the NARUC positions may be at variance with the view of the Arkansas Commission and I will note these distinctions.

INTERCONNECTION; NET METERING; DEMAND MANAGEMENT

While NARUC supports national technical power quality standards adopted by appropriate technical standards organizations, we must oppose the provisions found in section 101 which provide for the Federal pre-emption of distribution interconnection terms, conditions, costs and rates. NARUC believes that Congress should support the States' authority to work with local distribution utilities and other stake-

holders, including the renewable and small generating community, to provide interconnection arrangements for self-generation units that utilize the local distribution network. NARUC considers this a safety and reliability issue, as well as a generation supply and potential cost shifting issue, and therefore State and local officials and retail customers should be responsible for working out cooperative solutions that best fit the specific circumstances of connection to a distribution system. This way the safety, reliability, and economic impact concerns of a particular project and system are not jeopardized by a generic rule promulgated without the benefit of the project and systems unique specifications.

While NARUC appreciates the efforts to permit States to establish additional requirements to those net metering standards promulgated by FERC, NARUC must also oppose the Federally pre-emptive provisions found in section 102. Once again we must stress that net metering is a retail issue subject to State jurisdiction. NARUC supports legislation removing federal barriers to State implementation of net metering. The most critical barrier involves the current lack of jurisdictional clarity over net metering. The Federal Power Act has been alleged to preempt State net metering programs, slowing development of this promising new approach to promoting competition and resource diversity. Therefore, the bill should be amended to promote State implementation of net metering programs of the States' own choosing, in the States' own time, rather than being forced to implement minimum standards of FERC's choosing.

With regard to section 103, NARUC supports demand management programs, but believes that retail demand reduction programs should be developed by the States under traditional State jurisdiction over retail services. Congressional action to provide for more robust and effective demand-side options, without FERC pre-emption of the States, can be accomplished.

For example, Congress could promote energy efficiency programs through increased funding, tax credits, and the setting of increasingly more efficient national building codes and standards for motors, lighting and appliances.

Congress could also promote planning strategies for maintaining a proper balance between supply and load, which includes demand-side management techniques (including price-responsive demand mechanisms), intermittent and renewable resources, conservation/energy efficiency programs, as well as traditional supply and transmission options. One good way for Congress to act in this area would be to authorize willing States to address these issues on a regional basis. I would note that regulators in Arkansas, Louisiana, and Mississippi and the Entergy Corporation supported legislation introduced by Senator Dale Bumpers in the early 1990's, which would have authorized States that regulated electric utilities operating under PUHCA to conduct integrated resource planning on a regional basis. I believe such approaches are even more appropriate now than ten years ago.

Finally, Congress should continue to provide funding for energy efficiency and conservation for low and moderate income consumers through programs that provide education, weatherization, housing improvements, installation of higher efficiency appliances, and similar usage reduction measures.

Taken together, these options could help lower costs to consumers, reduce load, conserve valuable resources, and lower costs to utilities, while spreading the costs and benefits to all retail ratepayers, rather than providing benefits to just large industrial customers.

PUHCA

Congress should reform the Public Utility Holding Company Act (PUHCA), but in doing so, should allow the States to protect the public through maintaining effective oversight of holding company practices and expanding State access to holding company books and records, independent of any similar authorities granted to the federal regulatory bodies. NARUC believes that Subtitle B of H.R. 3406 fits within our criteria for support.

PURPA

NARUC supports legislation to lift PURPA's purchase requirement where a State determines that generating markets are competitive or that the public interest in resource acquisition is protected. However, NARUC opposes pre-empting State jurisdiction by granting FERC authority to order the recovery of costs in retail rates or to otherwise limit State authority to require mitigation of PURPA contract costs. It is NARUC's position that the States that have already approved these contracts are in a better position to address this issue than FERC.

In section 133, FERC is directed to promulgate and enforce regulations to provide for recovery of PURPA costs. Therefore, NARUC cannot support the PURPA provisions found in H.R. 3406.

REGIONAL TRANSMISSION ORGANIZATIONS (RTO)

On the important issue of RTOs, NARUC believes that RTO formation can provide benefits to the market and all customers, provided the policies that establish RTOs enhance the Federal-State partnership and provide for truly independent RTO governance and operation with appropriate Federal and State oversight. The Arkansas Commission has been one of the strongest State commission supporters of FERC's efforts to facilitate the formation of RTOs. However, we remain concerned that an appropriate role for State regulators in both RTO creation and operation has not been formalized.

Unfortunately, H.R. 3406 does not advance State participation in any aspect of RTO governance or decision making. The mandatory participation provisions of H.R. 3406 fail to recognize that currently, under State laws, utilities are generally required to obtain State commission approval to participate in RTOs, if RTO membership requires the utility to relinquish control or divest the transmission facilities held in the retail rate base. For instance, the utilities whose facilities comprise existing RTOs, which are "grandfathered" in section 202 (h) (6) on page 64, received State commission approval to participate in those RTOs.

Congress should require FERC, in cooperation with the States, to determine boundaries, structure, and functions for regional transmission organizations (RTO). The RTOs should be given sufficient authority to perform regional grid management and expansion, while providing for efficient system operations that are built and operated in the most economical, reliable and environmentally acceptable way in order to realize shortterm and longterm reliability as well as facilitate efficient wholesale market transactions.

Congress should require FERC to recognize the States' interest in actively reviewing questions of RTO governance. This would include: development (and revision) of market rules; reliability and planning; access to RTO market monitoring information; and development, with federal authorities, of market power mitigation programs.

In addition, Congress should require that RTOs or other regional bodies have sufficient authority to conduct long term planning for their regions and, working with the States and transmission owners, implement long-term planning that should:

1. Recognize the need for new investment in transmission facilities;
2. Assures that reliability is not compromised;
3. Reduces any decisional role for entities with unreasonable market power; and
4. Provides a cost allocation method that is objective, non-discriminatory, weighs environmental and societal risk, and ensures that costs are allocated in a proportionate manner to those that receive the benefits.

TRANSMISSION RELIABILITY

In numerous communications with this Subcommittee, both in letters and in testimony, NARUC has consistently and repeatedly expressed the belief that reliability should be addressed in any Federal electricity legislation. Our position as to what policies must be included in any reliability legislation have been equally consistent.

NARUC believes that Congress should mandate compliance with industry-developed reliability standards for the bulk power system, while preserving the authority of the States to set more rigorous standards when deemed to be in the public interest. Congress should also ensure that States continue to have the authority to establish effective price signals that allow consumers to choose alternative levels of reliability and power quality. To that end, Congress should expressly include in legislation: (1) a savings clause to protect existing State authority to ensure reliable transmission service, and (2) a regional advisory role for the States.

We would like to thank you Mr. Chairman for including in Title III of H.R. 3406 the savings provisions that were substantially the similar to those savings provision included in S.2071 which was passed by the Senate during the 106th Congress. However, I would also like to bring to your attention that H.R. 3406 does not address a regional advisory role for the States, which is especially critical to western States.

Reliability language should not fail to provide a continuing role for States in ensuring reliability of all aspects of electrical service, including generation, transmission, and power delivery services or results in FERC's preemption of State authority to ensure safe and reliable service to retail consumers. State officials will be held accountable by the public when the lights fail to stay on. Because of this

responsibility, State officials and regulators are particularly concerned that they be able to act effectively to ensure uninterrupted electricity service.

TRANSMISSION SITING AUTHORITY

NARUC strongly opposes any legislative provisions that contemplate Federal siting authority. States should retain authority to site electric facilities, while Congress should support the States' authority to negotiate and enter into cooperative agreements or compacts with federal agencies and other States to facilitate the siting and construction of electric transmission facilities as well as to consider alternative solutions to such facilities, such as distributed generation and energy efficiency. Here again Congress should authorize the development of regional approaches in this area.

Giving FERC eminent domain and siting authority is not a panacea. Beyond the practical matter of the time FERC would need to be prepared to assume this new role and the additional funds that Congress would need to appropriate to accomplish this, NARUC does not believe that many examples actually exist, beyond anecdotal evidence, where a State action (or inaction) is solely responsible for unreasonably preventing a needed transmission project. Further, the numbers of examples that may exist do not warrant Federal pre-emption in this area.

In addition, there may be alternatives to a specific transmission project. A State may determine that a transmission line is not necessary if, for example, distributed generation is used instead, thereby saving valuable resources and protecting citizens from the unnecessary effects of the transmission project.

While the Arkansas Commission does understand the basis for the recommendation by some parties that transmission siting authority should be vested in the FERC, we would recommend that the States, utilizing where appropriate regional mechanisms, continue to have primary siting authority. If such regional approaches once employed prove inadequate, the question of FERC's role can certainly be revisited.

CONSUMER PROTECTION

NARUC's members have a long standing commitment to consumer protection. Indeed, State utility commissions were established to ensure that consumers received essential services without fear of predatory practices and pricing. Therefore, we compliment you for your attention, Mr. Chairman, to the consumer issues that are found in H.R. 3406. However, while we favor strong consumer protection measures, NARUC does not believe that pre-empting the States by Federally legislating retail consumer protections is the way to go. The States are more capable in dealing with abuses that occur at the retail level, and in fact many, if not most, of the States that have moved to restructure and unbundled their retail electric markets have in place regulations or laws that address the consumer issues found in H.R. 3406. In short, Congress should not limit State authority to prescribe and enforce laws, regulations or procedures regarding consumer protection.

NARUC believes that it would be helpful if Congress would reinforce the States' authority to require all load serving entities to disclose generation sources and accompanying environmental impacts. Additionally, Congress should require regional transmission organizations, system operators, reliability counsels and other regional agencies to adopt policies that allow public access to information necessary to enable adequate monitoring of energy markets, while also providing protection for information demonstrated to be commercially sensitive.

Mr. Chairman, in conclusion, NARUC would again like to thank you for your efforts on this legislation and for offering us an opportunity to express our views. For your review and information I have included, as part of this testimony (Attachment1), a copy of the NARUC National Electricity Policy that was adopted by the NARUC membership at our Annual Convention in November.

Unfortunately, NARUC cannot support H.R. 3406 as drafted. We do not believe that a compelling case has been made for Federal pre-emption of State retail authority. It is the position of NARUC that Congress can do a great deal to advance and enhance the wholesale market without risking possible harm to those retail institutions that have heretofore not experienced the major dislocations that have occurred in wholesale markets.

NARUC would welcome the opportunity to work with you and your office prior to the Subcommittee markup to address the concerns raised here today. I would be happy to answer any questions you may have.

ATTACHMENT 1

NARUC'S NATIONAL ELECTRICITY POLICY

I. GENERAL PRINCIPLES

The nation's energy policy should assure adequate, reasonably priced, reliable, safe, and environmentally sound electricity. To achieve this goal, Federal legislation should:

1. Encourage additional fuel- and technology-diverse supply resources to meet the nation's growing energy demands;
2. Promote demand-side management to achieve the most efficient use of electricity;
3. Provide for reliability standards and their enforcement;
4. Assure open and effective regional wholesale markets;
5. Minimize the environmental impacts of energy generation, delivery and use; and
6. Respect, preserve and strengthen the States' traditional roles in regulating distribution systems, planning, siting approval, reliability assurance, and consumer protection.

II. DIVERSE, PLENTIFUL AND ENVIRONMENTALLY RESPONSIBLE ENERGY SUPPLIES

A. Congress should encourage environmentally responsible electricity generation and the increased use of renewable energy technologies as a tool to achieve fuel diversity and greater energy security.

B. Congress should encourage domestic exploration and production of new natural gas supplies and expansion of natural gas transmission and delivery infrastructure in an environmentally sound manner at reasonable costs, but should avoid an overreliance on natural gas for new electric generation.

C. Coal fuels a significant portion of the nation's electric power and is expected to do so for the foreseeable future. However, because of coal's air emissions, it is important that Congress and States work together to reduce such air emissions and encourage development of lowpolluting central station generation, including clean-coal technology.

D. Congress or the Administration should increase the efficiency for licensing and relicensing processes of hydroelectric and nuclear facilities, without compromising substantive environmental and safety standards.

E. Although nuclear facilities create long-term radioactive waste problems, they should continue to play an important part of our national electric supply portfolio because they provide a significant portion of the nation's electricity supply and do not produce air emissions.

F. Congress needs to fulfill its commitment to provide the long-term storage of spent nuclear fuel very quickly. To accomplish this, Congress should ensure that the Nuclear Waste Fund revenue and appropriations are managed responsibly and used only for the establishment of a permanent repository. Pending development of a permanent repository, it is better to store spent fuel at one (or more) central location(s) on an interim basis than to leave it at reactor sites.

G. The States support ongoing and renewed efforts to maintain the security of nuclear power plants and prevent the proliferation of weapons-grade byproducts.

H. Congress should enact legislation to lift the Public Utility Regulatory Policies Act's mandatory purchase requirement, but should allow the States to determine appropriate measures to protect the public interest in resource acquisition and to address mitigation and cost recovery issues associated with these contracts.

III. DEMAND MANAGEMENT

A. Congress should promote energy efficiency programs through increased funding, tax credits, and the setting of increasingly more efficient national building codes and standards for motors, lighting and appliances.

B. Congress should promote planning strategies for maintaining a proper balance between supply and load that includes demand-side management techniques (including price-responsive demand mechanisms), intermittent and renewable resources, conservation/energy efficiency programs, as well as traditional supply and transmission options.

C. Congress should continue to provide funding for energy efficiency and conservation for low and moderate income consumers through programs that provide education, weatherization, housing improvements, installation of higher efficiency appliances, and similar usage reduction measures.

IV. RTOS, RELIABILITY, PLANNING & DELIVERY INFRASTRUCTURE

A. Regional Transmissions Organizations

1. Congress should require the FERC, in cooperation with the States, to determine boundaries, structure, and functions for regional transmission organizations (RTO).
2. Congress should require the FERC to give RTOs sufficient authority to perform regional grid management, expansion, and efficient system operations that are built and operated in the most economical, reliable and environmentally acceptable way to realize shortterm as well as longterm reliability and facilitate efficient wholesale market transactions.
3. Congress should require the FERC to recognize States' rights to active participation in RTO governance. This would include development (and revision) of market rules, reliability and planning, access to RTO market monitoring information, development, with federal authorities, of market power mitigation programs.

B. Long-term planning

1. Congress should require that RTOs or other regional bodies have sufficient authority to conduct long term planning for their regions and, working with the States and transmission owners, implement long-term planning that should:
   (a) Take into account fuel diversity including renewables resources;
   (b) Recognize the need for new investment in generation and transmission facilities that provides adequate reserve margins;
   (c) Assure that reliability is not compromised by resource imbalances;
   (d) Reduce any decisional role for entities with unreasonable generation or transmission market power;
   (e) Include broad public participation and collaboration among market participants and third party participation in offering competitive alternatives such as demand-side and distributed generation options;
   (f) Develop a cost allocation method that is objective, non-discriminatory, weighs environmental and societal risk, and associates costs with benefits;
   (g) Allow the use of competition, subject to appropriate regulatory oversight, to encourage robust wholesale markets; and
   (h) Assure adequate resources in all regions of the nation.
2. Congress should support the States' authority over local distribution utilities to provide interconnection arrangements for selfgeneration and generation units that utilize the local distribution network.

C. Reliability

1. Congress should mandate compliance with industry-developed reliability standards on the bulk power system that include adequate reserve margins and preserve the authority of the States to set more rigorous standards when deemed to be in the public interest.
2. Congress should ensure that States continue to have the authority to establish effective price signals that allow consumers to choose alternative levels of reliability and power quality.

D. Delivery Infrastructure

1. States should retain authority to site electric facilities, while Congress should support the States' authority to negotiate and enter into cooperative agreements or compacts with federal agencies and other States to facilitate the siting and construction of electric transmission facilities as well as to consider alternative solutions to such facilities, such as distributed generation and energy efficiency.
2. Congress should pursue policies that promote and ensure pipeline safety, and streamline existing siting processes to increase administrative efficiency, including the coordination of all federal, State and local participation in these processes, without compromising substantive environmental and safety standards.

V. ENERGY MARKETS

A. Access to Information

1. Congress should recognize that States implementing competitive retail markets and those with traditional regulatory structures, and Federal, State and regional agencies and organizations overseeing the development of wholesale energy markets require comprehensive and timely market information. Congress should adopt policies that safeguard public access to information necessary to enable the monitoring of these markets, while also providing protection for information demonstrated to be commercially, or otherwise, sensitive.

B. Retail Markets

1. Congress should not interfere with the States' authority over all aspects of retail service including the authority to determine just and reasonable retail rates, and those retail rates designed to encourage reductions in peak demand and to encourage demand-side management options.
2. Congress should not mandate retail electricity competition.

C. Wholesale markets

1. Congress should require the FERC to promulgate clear and consistently applied market rules that foster investment in generation, transmission and demand-side management resources.
2. Congress should mandate effective and independent monitoring of the wholesale electricity markets and empower the relevant States and federal agencies with authority to investigate, enforce, and remedy problems resulting from the exercise of market power or other abusive behavior that distorts market operations. Such remedies should include the use of structural remedies, codes of conduct, or affiliate rules.
3. Congress should preserve a State's ability to require that a utility's retained generation be used to serve native load.

VI. ENVIRONMENTAL PROTECTION

A. Congress should assure that State and federal energy and environmental policies be coordinated and complementary.
B. Congress should address all air emissions from all electric power generation in ways that: 1) minimize adverse environmental impacts; 2) are comprehensive and synchronized to reduce regulatory costs; 3) rely, to the extent possible, on market-based trading mechanisms, and 4) identify, to the extent possible, the net impact of resource decisions, including external factors, on public health, the environment and the economy.
C. Congress should assist States and utilities to establish programs to phase out power plants grandfathered under the Clean Air Act with facilities that utilize clean coal technology or by other means, in a way that preserves the integrity of the bulk power system and minimizes the economic impact on local areas.

VII. CONSUMER PROTECTION

A. Congress should not limit State authority to prescribe and enforce laws, regulations or procedures regarding consumer protection.
B. Congress should reinforce the States' authority to require all load serving entities to disclose generation sources and accompanying environmental impacts.
C. Congress should address the preservation of public benefits in any electric industry restructuring legislation. Societal costs and benefits should be studied prior to the adoption of any particular implementation or funding mechanism.
D. Congress should require regional transmission organizations, system operators, reliability counsels and other regional agencies to adopt policies that allow public access to information necessary to enable adequate monitoring of energy markets, while also providing protection for information demonstrated to be commercially sensitive.
E. Congress should reform the Public Utility Holding Company Act (PUHCA), but, in doing so, should allow the States to protect the public through maintaining effective oversight of holding company practices and expanding State access to holding company books and records, independent of any similar authorities granted to the federal regulatory bodies.

Mr. BARTON. Thank you.

The Chair would recognize himself for the first 5 minutes of questions. Commissioner Hunt, you stated that your agency supports repeal of PUHCA you said with proper safeguards. Could you elaborate on the proper safeguards, please?

Mr. HUNT. Yes, sir. The proper safeguards in our view would be giving access to books and records both to State regulatory authorities and auditing powers, and access to, books and records of utilities to the FERC.

We think that is necessary for FERC to look at affiliate transactions, cross-subsidization, and for the States to have enough power to audit the utilities in their particular States.

Mr. BARTON. And do you consider the provisions on H.R. 3406 with regards to the safeguards to be acceptable or appropriate, or do you think we need to enhance them in some way?

Mr. HUNT. I think they are adequate, sir, but I would accede to FERC on that issue, because they will be the ones at the Federal level who would really have the power under the bill to audit the books and records of the utilities.

Mr. BARTON. Okay. Chairwoman Hochstetter, do you think that NARUC would ever support a Federal bill?

Ms. HOCHSTETTER. Well, certainly. It would just depend on the language within the Federal bill.

Mr. BARTON. But we have to have a Federal system, and you are looking at the most States' rights chairman you are going to have on this subcommittee, and I have bent over backwards to prevent preemption of the States' rights in almost every title of the bill.

And you are a very eloquent spokeswoman, but basically everything in the bill to protect the States doesn't go quite far enough to protect the States in your written testimony, which means that if we go far enough, we don't have a Federal bill.

So if you were me, what would you do? Would you just throw up your hands and say the heck with it, and let these great States that have been out there for all these years squabbling among themselves continue to squabble?

Or would you just pass a bill that says let FERC do it, instead of letting the Congress do it, where you have a little input?

Ms. HOCHSTETTER. Mr. Chairman, honestly, there is much about this bill that we can support, and I think if I were in your shoes, I would ask NARUC for specific wording provisions, some specific amendatory language that might be acceptable to the organization and to individual States to address these particular preemption concerns that I have identified.

Mr. BARTON. Well, we have been doing that for 3 years.

Ms. HOCHSTETTER. Well, we would certainly be happy to give another go at it.

Mr. BARTON. And we will be happy to give you another go at it, but we have got about a week to let you have a go at it. I did listen with detail to what you said, and when you talked about a savings clause, I think we can work on that.

I don't see a way around the RTO issue, and I just think it is going to be real tough to create a national system if we don't change to some extent the status quo at the State level on a fallback position on transmission siting.

And if I heard you correctly, you said that NARUC, that if the States can't agree, instead of letting the FERC come in at the end like we do, and let the FERC make the decision, your group apparently wants to create some sort of a regional arbitration panel; is that correct?

Ms. HOCHSTETTER. Mr. Chairman, the States have been engaged in recent discussions with FERC on creating regional advisory panels, or regional advisory boards, to work with FERC on RTO issues.

And I think that that mechanism with respect to RTO issues could also work for transmission siting. And I also think that there have been some approaches, particularly in the Western part of the

United States, where groups of States have worked together to work through transmission citing issues.

In my part of the country, which is your part of the country as well, I am not aware of any transmission projects that have not been able to go forward. I think that these cases may be isolated where there have been problems.

I think it may be a spotty thing, as opposed to a universal problem that needs a universal fix. So that's why I had respectfully suggested that we may want to approach it in a more moderate basis.

Mr. BARTON. Do you think that NARUC is willing to allow the RTO body, once it is in power, to make the final siting decisions?

Ms. HOCHSTETTER. I think it is entirely possible, Mr. Chairman, that if the States had a strong real formalized role in RTO governance decisions, then siting could become part of that process, yes, sir. But it would depend upon the structure of our role, our ongoing role with respect to RTO governance and operation.

Mr. BARTON. And, of course, our RTO proposal that is in the bill gives the States that real authority in the RTO creation. You are aware of that?

Ms. HOCHSTETTER. That's correct.

Mr. BARTON. And you like that part of the bill?

Ms. HOCHSTETTER. Yes, sir. I think it is the ongoing involvement on a day-to-day operational basis that we would like to see strengthened in the bill.

Mr. BARTON. Thank you. My time has expired. The gentleman from Virginia, Mr. Boucher.

Mr. BOUCHER. Thank you, Mr. Chairman. Ms. Hochstetter, I share your view with respect to the need to retain State authority over the siting of transmission lines, and frankly I don't think the case has been made that States have abused their discretion to site these lines in a way that would warrant this grant of Federal siting authority.

So we are in agreement on that. Tell me if you would what some of the concerns that States have to consider are when the decision is made whether or not transmission lines should be approved?

Ms. HOCHSTETTER. Yes, sir. I am glad that you asked that question. There are a number of things set out in our statute that we must consider, in addition to getting the input of a number of other State agencies.

There are citing issues involving historic property, landowners rights, environmental quality, endangered species, and then on an economic basis, there are cost benefit ramifications, in terms of making sure that the infrastructure and its costs are in fact allocated in a manner that provides benefits to those that pay the costs.

Mr. BOUCHER. Are you aware of any instances cited by the proponents of this grant of Federal authority to site transmission lines, where the claim has been made that the State has acted arbitrarily in balancing these competing interests of new transmission lines on the one hand, versus the other values that you have mentioned on the other, that the State has not engaged in a reasonable balancing process?

And that it has in some way its discretion to weigh these various values and come to a decision? Are you aware of instances where the allegation has been made of some abuse of discretion in that regard?

Ms. HOCHSTETTER. I have honestly only heard of one antidotal story, and I don't have much information or knowledge on it. And so I did find it somewhat interesting that that was a proposal in the legislation, because from my knowledge and experience—and I have been in this industry for 17 years—I am not aware of any line that was necessary that has failed to be sited.

I am sure that there may be one or two examples, but I am not aware of any.

Mr. BOUCHER. Okay. Well, I have been asking that question to a number of witnesses who have been testifying before this subcommittee this year, and we have yet to hear examples from anyone that would suggest that States have acted inappropriately, and would lend credence to the claim that there needs to be Federal authority in this area.

And let me just ask one additional question, and that relates to a way in which we might encourage the investments to be made in new transmission lines where they in fact have to be built.

A number of proposals have been put forward to address that concern. The bill contains a new system of incentive pricing authorities for the FERC. I would welcome your view with regard to the appropriateness of incentive pricing as a way to encourage and incent new power line construction.

And I would also welcome your view with regard to whether or not there might be another alternative. And that is sufficiently to empower regional transmission organizations to bid out the construction of these lines themselves.

And perhaps ultimately to be the owner of the newly constructed lines. Your thoughts on that alternative and whether or not that might work?

Ms. HOCHSTETTER. Yes, sir. Thank you. I am honestly not aware of any examples, at least in my State and in my regional of the country, where traditional cost of service based rate making has not be sufficient to incent transmission owners to build new transmission.

Certainly incentive rates might provide more encouragement and inducements, but I am not aware of the fact that we are at that point where that is absolutely necessary. I think it is something that could be considered at some point.

But we do have to keep in mind that when you use a rate design that it generally increases retail rates to consumers. So there is a balancing act that has to go into the process, and I would think that from a logical standpoint that you would start with the cost of service basis for incremental transmission construction.

And if that didn't work, then move to something else, but I don't think you have to jump over that first phase necessarily to get new transmission constructed.

Mr. BOUCHER. Okay. Mr. Chairman, those are my questions. Thank you very much.

Mr. LARGENT [presiding]. I thank the gentleman. The gentleman from Illinois, Mr. Shimkus, is recognized.

Mr. SHIMKUS. Thank you, Mr. Chairman. I will have just a brief question for Chairman Hochstetter. Define retail. In your statement, you talked about retail issues. Define retail for me.

Ms. HOCHSTETTER. There are a couple of different definitions that I might proffer. One is those program that have to do with services provided off of the distribution facilities, which is what State regulators regulate everything that is of a distribution nature.

Another definition of retail might be those rates, programs, and services offered to residential, commercial, and industrial customers.

Mr. SHIMKUS. Is there not another definition of retail? Could there not be retail over the transmission lines?

Ms. HOCHSTETTER. A portion of the transmission lines certainly are involved in retail service, and of course from the standpoint of the bundled service that we still have, a majority of the transmission service is in fact retail.

Mr. SHIMKUS. Now, if we have a generating facility in Arkansas, and a manufacturing plant in Missouri, by the Constitutional definition that would be interstate commerce would it not?

Ms. HOCHSTETTER. That's correct, and based on my understanding, Missouri would have to have retail open access to allow that manufacturing plant in Missouri to buy from the merchant plant in Arkansas.

Mr. SHIMKUS. Okay. What about Illinois?

Ms. HOCHSTETTER. Then in that scenario, that plant or the manufacturing plant in Illinois would certainly be free to purchase from the merchant plant in Arkansas.

Mr. SHIMKUS. Would it not make an argument for our role in the debate referencing interstate commerce to try to create that national grid as the chairman has so aptly attempting to do?

Ms. HOCHSTETTER. I agree that the division lines are somewhat gray at times, because certainly the transmission commerce is a mixture of retail and wholesale.

Mr. SHIMKUS. And I think that is probably the fundamental principle of what we try to address here on this committee, and as the committee Members have stated, this is the only committee really defined by the Constitution that deals with interstate commerce.

It is really a tough argument to make these days that wholesale, i.e., and some retail, are not interstate commerce and should be kept solely for the jurisdiction of the control of the State, and that's why we probably are going to move in some direction.

And we would rather that you be helpful than adversary, and with that, Mr. Chairman, I yield back the balance of my time.

Mr. LARGENT [presiding]. I thank the gentleman. The gentleman from Michigan, Mr. Dingell, is recognized.

Mr. DINGELL. Mr. Chairman, I thank you for your courtesy, and I commend the chairman for this hearing. To the witnesses, I am going to give you questions which I hope can be answered yes or no.

Your testimony states this morning that repeal of the Act would eliminate regulatory restrictions that prevent utility holding companies from owning utilities at different parts of the country, and to prevent non-utility businesses from acquiring regulated utility.

I interpret this as meaning that but for PUHCA, Enron could have acquired regulated utilities. Is that correct?

Mr. HUNT. Mr. Congressman, I don't think—that may be correct. Enron is exempt from PUHCA now because it does not operate a utility outside of Oregon, where it is incorporated.

Mr. DINGELL. So they could then have bought it either way?

Mr. HUNT. They could have bought another utility outside of Oregon, and they would have probably become an interstate company obviously, and been subject to the Act.

Mr. DINGELL. So if they bought one outside?

Mr. HUNT. Yes, sir.

Mr. DINGELL. So the answer to the question then is yes. Now, let's look at the accounting in the Enron matter. It was celebrated perhaps by meeting one of two tests. It was either incompetent or it was criminal, or perhaps both.

Having said that, in that case, wouldn't you and I now be sitting here discussing how State regulators would be faced with the massive job of shifting through Enron's extraordinarily complex corporate structures where evidence of cross-subsidization of non-energy investments financed by captive utility consumers?

Mr. HUNT. Mr. Congressman, as you know, my agency has just begun a serious investigation of the Enron matter, and it would be difficult for me to speak either about the accounting issues or anything specific about Enron until we have all the facts with respect to our investigation.

Mr. DINGELL. Well, would you not now then be in a situation of rubbing around through Enron's accounting to find whether or not there was evidence of cross-subsidization of non-energy investments being made by charging captive utility consumers for the costs of that?

Mr. BARTON. After he answers the question would the gentleman yield?

Mr. DINGELL. I would be happy to yield for the Chair. But isn't that a real possibility, and you would be here discussing that with me this morning?

Mr. HUNT. Sir, the SEC's Office of Chief Accountant is going to look very seriously at, and our other accountants are going to look very seriously and note, all the ramifications of the accounting problems as they relate to Enron.

And I am not going to guess as to what they are going to find, but they will be looking at the whole accounting issue with respect to Enron.

Mr. DINGELL. I am not asking for that answer. All I am doing is saying we would have been in the awkward position then of probably having to be looking to see if Enron was using captive utility consumers' payments to subsidize cross-fertilization of investments; isn't that right?

Mr. HUNT. That is a possibility, as I said, Mr. Congressman. They only own one utility.

Mr. DINGELL. And as you have already told me, but for PUHCA, they could have bought more?

Mr. HUNT. Yes.

Mr. DINGELL. Now, in the light of what we are now learning, is the SEC confident in its earlier contention that the books and

records protection is an adequate legislative offset for repealing PUHCA?

Mr. HUNT. I think that FERC would be better able to handle that. They are the ones that we would suggest should have the books and records authority at the Federal level.

Mr. DINGELL. Isn't it fair to observe that on securities matters that the SEC is the premier and the major, and the principal Federal Agency dealing with securities matters?

Mr. HUNT. Yes, sir.

Mr. DINGELL. And PUHCA is, of course, a twofold responsibility of the Federal Government; a part deals with energy, but more importantly, a part, or the principal part, deals with securities because it was directed at dealing with the outrages committed by Mr. Ensel in the 1920's; isn't that right?

Mr. HUNT. Yes, sir.

Mr. DINGELL. Very good. I thank you. Mr. Chairman, I am happy to yield to you.

Mr. BARTON. I thank you, Congressman. You know, I was talking to the staff when you started your question, and so I may have missed the premise. But my understanding is that Enron is not a public utility holding company under the PUHCA.

So that what Mr. Dingell was asking you was really more of a hypothetical question than a real time question, because they are not subject to PUHCA.

Mr. HUNT. They are not subject to PUHCA, because they only operate utilities in one State, the State in which they are incorporated.

Mr. BARTON. And if they had been a PUHCA regulated company would their books have been looked at in any more detail than they should have been looked at under the reality of how they have been regulated or been reviewed by the SEC?

Mr. HUNT. Well, the——

Mr. BARTON. The gentleman has yielded to me to let you have a pop at answering my question.

Mr. HUNT. I think that certainly I can't see anything different, Mr. Chairman, with respect to the relationship between the outside auditors and the company itself.

Mr. BARTON. I would ask for unanimous consent that the gentleman from Michigan be given an additional 2 minutes since he yielded to me on his last 15 seconds, and obviously I have peaked his interest by my question.

Mr. DINGELL. Mr. Chairman, I thank you, and you have helped with the point. But the point that we come down to is under PUHCA the Enron folks had one utility, and the Enron folks could not under PUHCA have owned, or bought, or acquired a second utility in another State.

And in that PUHCA precluded certain fine possibilities of serious misbehavior by the Enron folks then; isn't that true?

Mr. HUNT. Sir, they could not have acquired a utility in another State without coming under the SEC's jurisdiction under PUHCA.

Mr. DINGELL. Right. So that would have had the practical effect then of preventing them from diversifying, right?

Mr. HUNT. They may not have minded being under PUHCA, sir.

Mr. DINGELL. And adding a splendid new level of complexity to some of the most obscure, murky, perhaps incompetent, or more perhaps a plainly dishonest aggregation of corrupt bookkeeping; isn't that right?

Mr. HUNT. I can't say whether it was corrupt or not, Mr. Congressman, because we have not completed our investigation.

Mr. DINGELL. Well, if it looks like a duck, and quacks like a duck, and flies a duck, let it be said that it is a duck. And I think here, dear friends, that we have before us a duck, or more correctly, an incorrect, incompetent, dishonest, and embarrassing bookkeeping.

Mr. SAWYER. Will the gentleman yield?

Mr. DINGELL. I am happy to yield to the gentleman if he wants to talk about this correct, incompetent, bookkeeping.

Mr. SAWYER. I just wondered. You do have some experience in duck hunting don't you?

Mr. DINGELL. I do. I also have some experience in correct and dishonest bookkeeping.

Mr. SAWYER. Truly as an observer, I'm sure.

Mr. DINGELL. It is from observation and not from engaging in the practice. Mr. Chairman, as always, you are courteous and kind, and I thank you for your graciousness.

Mr. LARGENT [presiding]. The gentleman's time has expired. I recognize the gentleman from Kentucky, Mr. Whitfield, for questions.

Mr. WHITFIELD. Mr. Chairman, actually, I am not going to ask any questions today.

Mr. LARGENT. Okay. All right. Then the Chair will yield to himself, as I am next in line here, and I have just one question. Actually, one comment and a question.

Mr. Hunt, I wanted to ask you, is it possible—and kind of following up on Mr. Dingell's line of questioning, if PUHCA had been repealed and Enron had gotten into more diverse utility company holdings, is it not possible that it would have raised Enron to another level of scrutiny by the SEC or by FERC that perhaps would have kept Enron out of trouble?

And I know that we are projecting into the future here, and thinking about possibilities, but it is my belief that perhaps if PUHCA had been repealed and Enron had gotten into where they held more than one utility company, that possibly they could have been scrutinized to a greater degree, and thereby avoiding some of the problems that they now find themselves in?

Mr. HUNT. Well, we would certainly hope that if PUHCA had been repealed FERC would have been given more power to examine the books and records of a company in the situation of Enron, particularly if they bought utilities outside of Oregon where they now own a utility.

So we would hope that FERC would expand its authorities and would have given close scrutiny to a company like that with its new powers.

Mr. LARGENT. Thank you, Mr. Chairman. Ms. Hochstetter, I would like to ask you a question. I was surprised a little bit by your response about cost of service rates, and that those are good enough to construct transmission.

Is it your belief that we have a shortage of transmission in this country today?

Ms. HOCHSTETTER. I believe it depends upon what type of transmission service you are talking about.

Mr. LARGENT. I am talking about interstate transmission.

Ms. HOCHSTETTER. To serve the bulk wholesale power market, it is my understanding that that is correct. I don't know that there is a constraint, at least in my part of the country, with respect to serving native load customers. But certainly the system is not configured in such a manner to serve the bulk wholesale power market.

Mr. LARGENT. So we are talking about interstate transmission, which is what we are talking about here in Washington, that you believe that there is a shortage in transmission to serve the bulk power grid?

Ms. HOCHSTETTER. Capacity. Maybe not necessarily a situation where you automatically have to go toward constructing new lines. But there are obviously as you know ways to enhance capacity without building new lines, and siting new transmission lines.

But I am certainly aware of and would acknowledge the fact that we will need incremental transition capacity, and probably lines in this country. But I am not necessarily convinced that incentive rate making is the first necessary step.

Mr. LARGENT. Well, we have heard stories and perhaps you haven't, of constraints—you know, Path-15 is one that we have heard a lot about in California, where there is a significant transmission constraint, intrastate constraint in California.

We have heard of constraints in Wisconsin and Illinois, between Chicago and Milwaukee, that there is serious constraints of transmission there. And I am just wondering if you feel like that the—I mean, your opinion is that cost to service rates are good enough for transmission construction today, then why aren't those transmission lines where there are constraints being constructed?

Ms. HOCHSTETTER. I think honestly, sir, one of the reasons is that because everyone is waiting to make investments until the RTO structure is a known quantity, and RTOs are actually implemented, and up and running.

I think people are delaying making investments until they know what that type of organization is going to look like. And what also the transmission pricing policies will be coming out of FERC.

You know, they have an interconnection note going on right now, the second phase of which will deal with incremental transition pricing policies. So I think that once we have the RTO system configured, and these new transition pricing policies, I think you will see folks stepping up to the bar and making transmission infrastructure investments.

Mr. LARGENT. Let me ask you a question about RTOs. I sat here when you were talking about that, and I had actually wanted to ask some of the panelists that we had yesterday this question.

How involved should FERC be in determining the size or number of RTOs in this country?

Ms. HOCHSTETTER. I think they should be very involved, and I think they should be involved in a partnership format with the

States, which is a step that they had taken, and we commend them greatly for doing that.

We have over the last few months begun to forge that type of partnership in an ongoing dialog with them on RTO issues.

Mr. LARGENT. Is less better in terms of the number of RTOs?

Ms. HOCHSTETTER. I honestly think it is a region specific question, and I think that Chairman Wood has recognized that, and I think that they have recently changed their position on four being the perfect number. So I think it is one of those things that has to be looked at on a region by region basis.

Mr. LARGENT. Okay. I see that my time has expired. Let's see. The Chair recognizes the gentleman from Ohio, Mr. Sawyer, for questions.

Mr. SAWYER. Thank you very much, Mr. Chairman. In light of the exchanges, Commissioner Hunt, let me just return to what I think Congressman Barton asked earlier. You make a very specific recommendation with regard to what you believe the role between the SEC and FERC ought to be with regard to affiliate transactions, audits, access to books, records, and continued protection of utility companies.

Do the provisions of the bill before us, 3406, satisfy your recommendations?

Mr. HUNT. I think so, Mr. Congressman. Obviously, you should also get the views of FERC, and whether they think that this power is adequately amplified in this bill for them to do the job, because we would be—if we had our way, we would be out of this business, and this business would belong to FERC.

Mr. SAWYER. Let me just make an observation before I move on. It strikes me that looking to the kinds of traditional solutions provided either by the SEC or FERC with regard to Enron may not be where we need to look.

It strikes me that Enron structured its business to operate in the seams between the controls put in place 65 years ago, and that those controls may not have been adequate even in the best of circumstances, but that is just an observation.

Mr. HUNT. I think part of that business was unregulated by us and by FERC, the trading part of the business. We regulate another part and FERC regulates another part, but as to the trading part, I think you are right. Neither of us regulates it under existing law.

Mr. SAWYER. It is good to see you here today.

Mr. HUNT. It's good to see you, too, sir.

Mr. SAWYER. Ms. Hochstetter, I guess I would agree with Mr. Boucher and with you with regard to the way in which the States have functioned, and I think to suggest that they acted arbitrarily or inappropriately, or abused discretion with regard to siting responsibilities that they have, it is an accurate observation to say that those kinds of things have simply not occurred.

And I think it is probably also true that any transmission that has been needed—I can't think of a circumstance anywhere in the country where it has been ultimately denied as a product of siting difficulties.

Our problem it seems to me, however, is that not just recently, and not just waiting for RTOs to come into place, but over the last

quarter of a century, we have seen a decline in investment, in overall transmission.

And that a transmission system designed to serve a cost of service environment, and with an obligation to serve a service territory, has worked.

But it has not created the broader grid of the kind that the Sitting Chair was suggesting, and that the decline year in and year out of over $100 million in investment in transmission has led to a system that over the long term has begun to atrophy in terms of the uses to which it has attempted to be put today.

That is to say, that for the bulk transmission and the functioning of a real grid in regional markets instead of a series of transmission lines cobbled together to meet the needs of a grid.

Having said that, could you describe for me the kind of RTO or kind of regional siting authority that you are talking about? Would it function within an RTO?

Would it have the authority to bring eminent domain to difficult siting decisions in the same way that the States can today? And when there is disagreement between existing siting authorities among States, who resolves it?

Ms. HOCHSTETTER. I think, sir, the vision that I had mentioned earlier on a regional basis would probably have to by law involve voluntary cooperation and coordination as the first step.

I am not certain that regional eminent domain authority is something that is appropriate. But I certainly think that a regional association of some sort, hand-worked through a majority, if not all of the difficulties, and should at least be a first step, a first effort that is made.

And to the extent that either an RTO isn't the one siting the authority or to the extent that the States can't achieve that.

Mr. SAWYER. When Arkansas confronted a difficult siting decision, you mentioned that you had an obligation to look at a number of questions, and included among those was whether or not it provides service to the people affected by the siting decision.

If in fact this is an interstate transmission line, and Arkansas disagrees with Texas and Louisiana, for example, how does that get resolved under the structure that you envision?

Ms. HOCHSTETTER. Well, I certainly recognize that you are not going to have a perfect scenario and that there could be problems. I think what I am just suggesting is that let's not jump over the first couple of alternative methods in getting to the ultimate objective.

I certainly acknowledge, and I am just speaking on behalf of the Arkansas Commission at this point, I will certainly acknowledge that at some point FERC's siting authority, or some kind of FERC backstop, might be appropriate and might be necessary.

But I don't think that you have to automatically go to that as your first approach, the first step if you will, in doing that if you like.

Mr. SAWYER. I would just submit that I believe that at least both the bill that the chairman has worked on, and the one that I have does give primary initial siting authority and sufficient time for the States to act directly.

But that that backup authority is put in place not as a first use, but in anticipation of potential problems.

Mr. BARTON. Would the gentleman yield?

Mr. SAWYER. With whatever I have left, I would be happy to.

Mr. BARTON. I would ask for unanimous consent that Mr. Sawyer have 2 minutes, and if you would yield 1 minute to me.

Mr. SAWYER. I would be pleased to do so.

Mr. BARTON. Let's use that hypothetical. Let's say you have a three State COMPAC, and Arkansas is right in the middle, and so we have Oklahoma and Tennessee, and we have this regional citing authority that you talked about.

And the regional citing authority has got one representative from the State of Arkansas, and one representative from the State of Oklahoma, and one representative from the State of Tennessee.

And the pending transmission line is an interstate line that goes from Oklahoma to Tennessee across the great State of Arkansas. The regional siting authority meets and it votes 2 to 1 to build it, the one vote being the State of Arkansas, and it says that we don't need it, and we don't get anything out of it, and we vote no.

If we went to that regional siting authority could we put language in the regional siting authority that would bind the losing State, the losing State, to exercise their State eminent authority, right of eminent domain, even if they lose? Would NARUC accept that?

Ms. HOCHSTETTER. Well, without checking with the NARUC officers and the NARUC board, I would have to say that I honestly don't know. It is an interesting hypothetical, and——

Mr. BARTON. Well, would you accept that? If you were the Commissioner representing the State of Arkansas in this three State COMPAC, and you voted no, but the other two States voted yes, and we were giving that State COMPAC the right to make the decision and not the FERC, would you accept that kind of a provision acting on behalf of the State of Arkansas?

Ms. HOCHSTETTER. I honestly don't know. I think I would have to look at to what extent, if any, there was an impact on retail rates.

Mr. BARTON. No, I am not talking about that. We are going to do something.

Ms. HOCHSTETTER. I understand, sir.

Mr. BARTON. We are going to get a national grid built, one way or the other. I want the States to have every bit of access and authority, and input possible, but at some point in time somebody has got to pull the trigger so to speak and say we are going to build it if it is in the regional interest.

Now, you put on the table this regional authority and that is not a unique brand new idea.

Ms. HOCHSTETTER. Right.

Mr. BARTON. I am willing to go down that road if I can get your group and your utility commissioners to accept that at some point in time, even acting on behalf of your State, that you vote no, and you still accept the overall product for the greater good.

But if you won't accept that, if NARUC won't accept that, then we will keep our backup authority at the FERC level.

Ms. HOCHSTETTER. Well, let me answer you on behalf of the Arkansas commission, because I honestly cannot speak based on your hypothetical on behalf of NARUC. Our Commission does not want to be parochial, and that is one of the reasons that we have been a strong advocate of RTOs at FERC.

And I think that we are somewhat unique, at least in our part of the country, in our support of the RTO concept. Along these lines——

Mr. BARTON. You have got some of the biggest merchant plants in the country being built in your State.

Ms. HOCHSTETTER. Yes, sir.

Mr. BARTON. And you want to get that power out there.

Ms. HOCHSTETTER. Provided that we get some benefit out of that, that's correct. But the concept of net public interest is near and dear to my heart and to our Commission's heart.

And if you are looking at something on a regional basis and the net public interest shows that the majority of the folks will benefit from the project, I personally do not have a problem with that, and I don't think our Commission would.

Mr. BARTON. I will take that.

Mr. LARGENT [presiding]. The gentleman's time has expired. I recognize the gentleman from Tennessee, Mr. Bryant.

Mr. SAWYER. Mr. Chairman, I yielded 1 minute of my 2. Can I have 1 minute as long as his?

Mr. LARGENT. Sure.

Mr. SAWYER. Well, probably not. Okay. Forget I asked.

Mr. BARTON. I am reinforcing your point, Mr. Sawyer.

Mr. BRYANT. Thank you. Madam Chairman, let me follow up on that, and not to beat a dead horse here, but this is a very important issue. Coming from the State of Tennessee, let me assure you that we probably would not vote against Arkansas in that scenario.

Ms. HOCHSTETTER. I appreciate that.

Mr. BRYANT. But we could always run it through Texas, or perhaps Missouri. This question though is that there is no question that the President and his energy policy, and the report indicated that we needed more infrastructure, and I don't think that is the issue here.

It is how we go about it, and by protecting State's rights, and regional rights, and even individual property owner's rights as we talk about this process. And I am interested in your testimony as it relates to the incentive pricing.

And a couple of times you have referred to in your statement or in your testimony today about not leaping over the cost of service and going right to the incentive pricing because ultimately we all know the rate payer is going to be charged with this.

And not necessarily seeing a direct visible benefit out of that, it is going to be difficult to accept. It is going to be very difficult in the Tennessee Valley, where we have become accustomed over the years to very reliable and inexpensive power, particularly to our residential customers and our constituents.

As we move toward this restructuring my constituents are very concerned about prices going up. So every point that is out there where this court occur, I know that the blame for that is going to

come back to restructuring in general, and those in Congress responsible for it.

And I am a rate payer also, and so I don't want to see that either. So I am intrigued that if there is truly a middle ground so that we don't leap over and go right to the incentive pricing.

But my question to you though is realistically—and I have always heard that that is—that people are waiting for Congress to act to provide some "stability" before they start building and putting money, and investing money in infrastructure.

Can we say how we would get there without incentive pricing? I mean, how do you say that we are not going to start out with this, but if it doesn't work, we will get to that, because everybody is going to hold out until it gets to that point?

I mean, how do you reasonably get some interim steps in there that would actually work, rather than people continuing to hold out on building until they get the money that they want to build?

Ms. HOCHSTETTER. Yes, sir. I think that FERC is ultimately going to need to take a lead in that, and so I think in terms of waiting for Congressional action, it is probably waiting for Congressional action to ask FERC to move forward in coordination and in consultation with the States to address some of these issues.

But I think that is something that could be done in a proceeding at FERC to discuss that type of cost of service, versus incentive rate design, and work through those issues in this consultative process that we have begun to form with the FERC.

So I think that is something that could be handled on an administrative basis, as opposed to in Congressional legislation, just to direct us to move forward in partnership, the States, in conjunction with FERC on these issues.

Mr. BRYANT. I have additional time, but I know there is a very qualified and competent second panel ready to testify, and I would waive the balance of my time so we can move on toward our second panel.

Mr. LARGENT. All right. The gentleman yields back his time, and I will recognize the gentleman from Louisiana, Mr. John.

[No response.]

Mr. LARGENT. Mr. Wynn, from Maryland.

[No response.]

Mr. SHIMKUS. Mr. Chairman, I have one additional question, but I am not up yet.

Mr. LARGENT. Well, maybe Mr. Walden would yield you time.

Mr. Walden. Mr. Chairman, I would be happy to yield to my colleague.

Mr. SHIMKUS. And I thank my colleague. For Mr. Hunt. I have been told from some Illinois utilities PUHCA has prevented them from refinancing bonds. Could this be true?

Mr. HUNT. Without knowing the facts of that case, Mr. Congressman, I couldn't answer, but I would be glad to get back to you with an answer.

Mr. SHIMKUS. Well, I don't question them, but the final question is if they do have an inability to refinance bonds under PUHCA at this time, understanding how rates have gone, we could then make a correlation that individual rate payers are not getting the advantage of the ability to refinance, and in essence are incurring higher

rates than they probably are, unless they were able to refinance. Is that a fairly good analysis?

Mr. HUNT. Well, I just don't know what PUHCA's involvement in that problem is, Mr. Congressman. Certainly if a utility can't refinance, the rate payers may suffer some harm. But to the extent that PUHCA and we had anything to do with the non-refinancing in this instance, I can't speak to that because I don't know the facts.

Mr. SHIMKUS. And if you would check to get that, I would appreciate that.

Mr. HUNT. I will try.

Mr. SHIMKUS. That is the only question I have, Mr. Chairman. Thank you.

Mr. LARGENT. The gentleman from Oregon, does he yield back his time? Do you have any questions?

Mr. WALDEN. I will save mine for the next panel, Mr. Chairman.

Mr. LARGENT. Okay. The gentleman from Georgia, Mr. Norwood. Do you have any questions for this panel?

Mr. NORWOOD. No questions.

Mr. LARGENT. Seeing no other requests for questions, I will excuse this panel. Thank you, Mr. Hunt, and Ms. Hochstetter, I appreciate your testimony, and we will ask the next panel to come in.

Ladies and gentlemen, we thank all of you for your willingness to testimony before this committee. I would ask you to summarize your remarks in 5 minutes, and I will begin by introducing Panel Two.

They are David Sokol, representing Mid-American Energy Holdings Company; Mr. Robert Johnston, representing the Municipal Electric Authority of Georgia; Mr. Alan Richardson, representing the American Public Power Association; Mr. Glenn English, an Oklahoman, also representing the National Rural Electric Cooperative.

And Mr. Michehl Gent, representing the North American Electric Reliability Council; Ms. Lynne Church, representing the Electric Power Supply Association; Mr. James B. Rouse, representing the Electric Consumers Research Council; Charles Acquard, representing the Consumers for Fair Competition; Mr. William Prindle, representing The Alliance to Save Energy; and finally Mr. Leonard Hyman, representing or with Salomom Smith Barney.

As I said, we welcome you and we will begin with Mr. Sokol to present your testimony in 5 minutes, and then we will move through the panel.

Thank you, Mr. Sokol.

STATEMENTS OF DAVID L. SOKOL, CHAIRMAN AND CEO, MID-AMERICAN ENERGY HOLDINGS COMPANY; ALAN H. RICHARDSON, PRESIDENT AND CEO, AMERICAN PUBLIC POWER ASSOCIATION; GLENN ENGLISH, CEO, NATIONAL RURAL ELECTRIC COOPERATIVE; MICHEHL R. GENT, PRESIDENT AND CEO, NORTH AMERICAN ELECTRIC RELIABILITY COUNCIL; LYNNE H. CHURCH, PRESIDENT, ELECTRIC POWER SUPPLY ASSOCIATION; JAMES B. ROUSE, DIRECTOR, ENERGY POLICY, PRAXAIR, INC., ON BEHALF OF THE ELECTRICITY CONSUMERS RESOURCE COUNCIL; CHARLES ACQUARD, EXECUTIVE DIRECTOR, NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES; WILLIAM R. PRINDLE, DIRECTOR OF BUILDING AND UTILITIES PROGRAMS, THE ALLIANCE TO SAVE ENERGY; LEONARD S. HYMAN, SENIOR INDUSTRY ADVISOR TO SALOMON SMITH BARNEY; AND ROBERT JOHNSTON, PRESIDENT AND CEO, MUNICIPAL ELECTRIC AUTHORITY OF GEORGIA, ON BEHALF OF THE LARGE PUBLIC POWER COUNCIL

Mr. SOKOL. Thank you, Mr. Chairman, for the opportunity to be here today. I am David Sokol, Chairman and CEO of Mid-American Energy Holdings Company, and my comments are fully endorsed today by our largest shareholder, Warren Buffett, and his Berkshire Hathaway Company.

Before providing comments on H.R. 3406, I would like to explain why we believe that moving forward with this legislation is so crucial. As the head of a company that provides the electrical load that feeds industry jobs and production, we have seen a very steady downward trend for much of this year that has accelerated in recent months.

We do not share the view of some who believe that this recession is destined to be either relatively brief or comparatively painless. Congress does, however, have in its power to take the steps that will spur the economy and reassure investors and consumers in this sector.

Passing real comprehensive energy legislation, a bill that contains electricity modernization as a fundamental component is vital to that effort.

This perhaps could be one of the most important stimulus measures this committee can pass for the American economic recovery. With regard to the bill, I would like to offer my comments section by section, and under Title One of Electricity Supply, Subtitle A, Mid-American fully supports this section.

Tough Mid-American does not have a financial stake in this area, we believe that distributed generation should be an integral part of the energy future of this country, and will deliver significant benefits to consumers and the environment.

We have some minor technical concerns on the net metering language, but establishing minimum standards to encourage States to adopt policies to promote generalization and with renewables is clearly appropriate.

Under Subtitle B regarding the Public Utility Holding Company Act, Mid-American strongly supports repealing PUHCA and replacing it with comprehensive provisions to enhance regulatory access to the books and records of all utility holding companies.

PUHCA is the most substantial impediment to new investments and energy infrastructure, keeping billions of dollars of new capital out of this industry. The SEC, FERC, State Regulators, the administration, and the Democratic leadership of the Senate, have all endorsed PUHCA repeal as necessary pieces of a national energy strategy.

It is in the words of your former colleague, Senator Tom Carper of Delaware, "a no-brainer." Subtitle C provisions regarding the Public Utility Regulatory Act, we strongly support these provisions as well, and we note that respective PURPA repeal is long enjoyed by partisan support.

Under Subtitle D, the redundant review of certain matters. Section 142 eliminates the redundant review of multiple agencies over utility mergers. This is a desirable provision, but I understand that there is significant opposition to certain parts of the section.

At a minimum, we would recommend establishing reasonable time limits on the FERC merger review period. Under Title II, Transmission Operations, Section 201 embodies the FERC like compromise, bringing non-jurisdictional utilities under limited FERC oversight.

Mid-American was one of the first investor-owned utilities to endorse this compromise and we support this section strongly. Section 202 on regional transmission organizations, or RTOs, includes many items that have been sought for years by advocates of a more transparent transmission system.

First, a date certain for RTO participation; and second, placing all uses of the system under the same tariff; and, third, independence requirements and minimum standards for RTOs.

The principles underlying this language is very sound; mandatory participation with flexible implementation. At the same time we understand that this section has received some criticism that it is too cumbersome, and perhaps too prescriptive.

We would suggest the work continue on the section as the bill moves forward through the process in order to refine these very sound concepts. Under Title III of transmission reliability, Section 301 is a streamline version of the reliability language that has been included in earlier bills.

This language has broad stakeholder support, and Mid-American supports and prefers this approach, and we could also accept the section on reliability in the Daschle and Bingaman bill.

The most important thing is that we must have a mandatory, enforceable, reliability system in place. Under transmission infrastructure, Section 401 addresses two priority issues for improving the transmission infrastructure.

Encouraging FERC to develop incentive rates for investments and new infrastructure, and requiring FERC to conduct a rulemaking on pricing to ensure adequate capitalization of stand-alone transmission entities.

These provisions are sound policy, and frankly shouldn't be controversial. Some of the other policy directives toward FERC we would characterize as clearly desirable, but not absolutely essential, and non-binding language could be appropriate.

Under Section 402, this is a very important section. Performing siting of interstate transmission lines is an issue that only Con-

gress can address. Every electricity consumer has a stake in fixing transmission bottlenecks, and making for a more wholesome transmission system.

While my first instincts would usually be unfettered protection of property rights, there must be some way to ensure that vital transmission infrastructure gets built for this country.

The formula that you have outlined will do the job, and we would encourage the committee to continue exploring options with the various stated entities involved.

Under Federal Utilities, we understand that these three sections represent consensus approaches by the stakeholders in the affected regions, and while we are not an expert on these issues, we commend that consensus approach.

And Mid-American strongly supports Title VI and VII of the Consumer Protection and related matters. Mr. Chairman, there is one other topic that I would like to address before I conclude, and that is the problems at Enron.

No one should make Enron or the Enron situation an energy issue. It is an issue of bad investments and the clear misuse of accounting. Energy markets are functioning fine without Enron.

This committee has a great history on matters of oversight investigations, and we applaud Chairman Tauzin on announcing his intentions to hold hearings on this matter. I also believe that Representative Markey has raised valid questions about the oversight of electricity trading markets that deserve the committee's attention.

But the subcommittee should not turn away from the task of doing its part to aid the economic recovery modernizing the vastly needed electricity laws and infrastructure because of the problems at one company, no matter how high profile that company is.

The changes that you are proposing under 3406 are very long overdue, and I would be happy to answer any questions that you might have.

[The prepared statement of David L. Sokol follows:]

PREPARED STATEMENT OF DAVID L. SOKOL, CHAIRMAN AND CEO, MIDAMERICAN ENERGY HOLDINGS CO.

Thank you, Mr. Chairman, for the opportunity to testify today. I am David L. Sokol, Chairman and CEO of MidAmerican Energy Holdings Company, a global energy company based in Des Moines, Iowa. I was pleased to testify before the Subcommittee earlier this year on the topic of barriers to competitive generation, and am appreciative that the subcommittee has allowed me to come back.

MidAmerican is a diversified, international energy company headquartered in Des Moines, Iowa with approximately $11 billion in assets. The company consists of four major subsidiaries: CE Generation (CalEnergy) a global energy company that specializes in renewable energy development in California, New York, Texas and the West, as well as the Philippines; MidAmerican Energy Company, an electric and gas utility serving the states of Iowa, South Dakota, Illinois and a small part of Nebraska; Northern Electric, an electric and gas utility in the United Kingdom, and Home Services.com, a residential real estate company operating throughout the country.

As head of a company that includes both regulated utility assets and independent, competitive generation assets, in addition to experience participating in the already-deregulated energy markets in the U.K., I hope I bring a balanced perspective to the consideration of these issues.

For the last three years, MidAmerican has taken a leadership role in attempting to build support for reasonable, middle ground solutions to modernizing the electricity industry.

In that spirit, I will attempt in my testimony to point out some areas of potential compromise that could resolve outstanding disagreements over the few remaining areas of dispute in this legislation. It is time for all stakeholders to engage to help resolve these issues. To do otherwise only serves the interest of those who seek to gain advantage from the existing inefficiencies in the system at the expense of energy consumers.

Mr. Chairman, in addition to your leadership in this area, I have been impressed by the commitment of both Secretary Abraham and the Democratic leadership of the Senate to ensuring that electricity modernization is a core component of our national energy strategy. They recognize that attempting to create a twenty-first century energy policy without modernizing electricity laws is akin to trying to install a high-speed rail system on seventy year-old tracks.

Before providing comments on H.R. 3406, I would like to explain why I believe moving forward with this legislation is so critical.

As the head of a company that provides the electric load that feeds industry, jobs and production, I have seen a steady downward trend for much of the year that has accelerated in recent months. I do not share the view of some who believe that this recession is destined to be relatively brief and comparatively painless.

Congress does, however, have it in its power to take steps that will spur the economy and reassure investors and consumers. Passing real comprehensive energy legislation—a bill that contains electricity modernization as a fundamental component—is vital to that effort. This perhaps could be one of the most important stimulus measures this committee can pass for American economic recovery.

With regard to the bill, I'd like to comment section-by-section:

Title I: Electric Supply

Subtitle A—Interconnection, Net Metering and Demand Management

MidAmerican supports this section.

I believe distributed generation should be an integral part of our energy future and will deliver significant benefits to consumers and the environment. The provisions in H.R. 3406 refine the principles of a stakeholder compromise between transmission and distribution owners and independent generators that will bring greater clarity and certainty to the interconnection process.

I know that there is some concern about addressing distribution interconnection in this section, but members should be aware that this section only mandates that a national technical standard be established where feasible and that generators pay the reasonable costs of interconnection. I would recommend a technical change to the bill to clarify the section on back-up power that we will provide to the committee staff.

The language on net metering should not overturn existing state net metering policies, but should establish minimum standards to encourage states to adopt policies to promote remote generation with renewables. Net metering will create some cost shifting to customers who are not net metered under the rate design used by most utilities today. These costs are for services that would otherwise be billed based upon the net metered customer's meter registration, but net metering eliminates that registration. Such costs include transmission and distribution service, billing and other customer services, taxes and system benefits charges. Determining the means for recovering these shifted costs is best left to the states.

Subtitle B—Provisions Regarding the Public Utility Holding Company Act of 1935

MidAmerican strongly supports repealing PUHCA and replacing it with comprehensive provisions to enhance regulatory access to the books and records of all utility holding companies.

PUHCA is the most substantial impediment to new investment in energy infrastructure, keeping billions of dollars of new capital out of this industry. The SEC, FERC, state regulators, the Administration and the Democratic leadership of the Senate have all endorsed PUHCA repeal as a necessary piece of the national energy strategy.

PUHCA places a set of arbitrary and often counter-productive limitations on investments in the regulated energy industry. It keeps new capital and new ideas out of the industry at a time when transmission infrastructure alone requires tens of billions of dollars in new investment. PUHCA requires the concentration of utility assets because of its physical integration standard, increasing concerns about market power.

PUHCA is an impediment to bringing new capital and new infrastructure into California's market because no entity that owns more than ten percent of any utility in the eastern two-thirds of the country could make a significant capital investment

in those companies or in regulated assets such as new transmission without running afoul of PUHCA. And, finally, PUHCA provides a "first bite" advantage to foreign-owned corporations seeking to acquire American utility assets.

Replacing PUHCA with up-to-date provisions that provide state and federal regulators with enhanced access to the books and records of all utility holding companies is, in the words of your former colleague, Sen. Tom Carper of Delaware, "a no brainer."

Subtitle C—Provisions Regarding the Public Utility Regulatory Policy Act of 1978

MidAmerican strongly supports these provisions and notes that prospective repeal of PURPA's Sec. 210 mandatory purchase requirement with full guarantee of cost recovery has long enjoyed bipartisan support.

Through our CalEnergy subsidiary, MidAmerican owns geothermal energy facilities that are QF producers. While PURPA has played an important role in opening up wholesale electricity markets, there have been cases where QF contracts anticipated higher levels of "avoided costs" than market conditions actually produced. At the same time, I'm pleased to note that the recent settlement in California between QF producers and one of the state's largest utilities will provide consumers clean, renewable electricity at a fraction of the cost of many of the long-term contracts for conventional generation signed by the state.

Virtually every state in the country is looking at more market-based methods of promoting renewable energy, and the PURPA Sec. 210 mandatory purchase requirement has become outdated.

Subtitle D—Redundant Review of Certain Matters

Section 141 of the bill eliminates the redundant review of multiple agencies over utility mergers. While I understand that there is significant opposition to this section, I would recommend at a minimum establishing some reasonable time limit on FERC merger review.

Placing a time limit on merger consideration would not in any way prejudice the outcome of FERC's proceedings, but it would provide the markets with greater certainty in making judgments on transactions.

Title II: Transmission Operations

Section 201 embodies the "FERC lite" compromise bringing non-jurisdictional utilities under limited FERC oversight. MidAmerican was one of the first investor-owned utilities to endorse the compromise and supports this section.

"FERC lite" brings all owners of transmission facilities that are used in interstate commerce under FERC jurisdiction for the purposes of establishing terms and conditions of service. FERC would also be given the authority to ensure that rates charged by currently non-jurisdictional utilities to users of their transmission systems are comparable to the rates those utilities charge themselves.

This is a major step forward in the creation of a seamless transmission grid while recognizing the different financial structures of different transmission owners.

Many non-jurisdictional transmission owners have already moved to place their assets in regional transmission organizations to ensure that their customers are not isolated from regional electricity markets. TRANSLink, the independent transmission company that MidAmerican has joined in the Upper Midwest, includes both public power entities and a large regional rural cooperative.

Section 202 on regional transmission organizations, or RTOs, includes many items that have been sought for years by advocates of a more transparent transmission system: 1) a date certain for RTO participation 2) placing all uses of the system under the same tariff and 3) independence requirements and minimum standards for RTOs. The principle underlying the language is sound—mandatory participation with flexible implementation.

At the same time, I understand that this section has received some criticism that it is too cumbersome and prescriptive. I suggest that work continue on this section as the bill moves through the process in order to refine the sound concepts you have laid out.

Title III—Transmission Reliability

Section 301 is a streamlined version of the reliability language that has been included in earlier bills. This language has broad stakeholder support. MidAmerican supports and prefers this approach, but could also accept the section on reliability in the Daschle/Bingaman bill. The most important thing is to get a mandatory, enforceable reliability system in place.

In recent years, as markets have become more competitive and transmission capacity more constrained, pressures on the transmission network have multiplied.

We were fortunate that mild weather in much of the country last year prevented any recurrences of the reliability problems we had seen in previous years, but voluntary compliance with reliability rules by organizations that do not have enforcement authority is not a viable long-term system.

Title IV—Transmission Infrastructure

Section 401 addresses two priority issues for improving the transmission infrastructure—encouraging FERC to develop incentive rates for investments in new infrastructure and requiring FERC to conduct a rulemaking on pricing to ensure adequate capitalization of stand-alone transmission entities.

Transmission costs are pennies on the dollar of retail electricity rates, but the cost of inadequate transmission capacity can be enormous. We need to get new transmission built to improve reliability, security and market efficiency. Incentive rates are one way to help get new transmission in the ground.

Congress also should direct FERC to review its transmission pricing policies to ensure that these policies will support stand-alone transmission entities. Rates of return must be adequate to attract capital to these new entities or else the system will deteriorate. Legislation should not dictate what rate of return that FERC provides for transmission, but FERC needs to look at this issue as it moves forward with RTOs.

These provisions are sound policy and should be non-controversial.

Some of the other policy directives toward FERC I would characterize as desirable, but not absolutely essential. Non-binding language may be appropriate.

Section 402 on transmission siting is very important. Reforming siting of interstate transmission lines is an issue that only Congress can address. Every electricity consumer has a stake in fixing transmission bottlenecks. My first instincts are usually unfettered protection of property rights, but there must be some way to ensure that vital transmission infrastructure gets built.

There are several problems here. When a proposed new transmission line or upgrade crosses through a number of states, not every state will benefit equally—some will not benefit at all. In other cases, because of complex transmission flows, a constraint in one state can only be addressed only by improving facilities in an entirely different state. Finally, a number of states are constitutionally prohibited from using their own eminent domain authorities for facilities that do not primarily benefit the public in their own states.

The formula you have outlined would do the job. MidAmerican also has been involved in talks with state regulators about an approach that would establish joint federal-state boards under Section 209a of the FPA to address interstate transmission issues such as new transmission line construction. If that approach would resolve concerns expressed by others about this section, I would encourage the Committee to explore it.

Title V—Federal Utilities

I understand that these three sections represent consensus approaches developed by stakeholders in the affected regions. While I am not an expert on these issues, I commend you and the representatives of these regions for your hard work and the compromises you have developed.

Titles VI and VII—Consumer Protection and Related Matters

MidAmerican supports these sections. Consumer protection should be foremost in the Committee's mind as it moves forward with electricity modernization. Nothing will turn consumers against the marketplace faster than abusive practices such as slamming and cramming. H.R. 3406 includes provisions in these areas that are very similar to those proposed by both the Clinton and Bush Administrations, as well as the bill introduced last week by Senators Daschle and Bingaman.

The bill's provisions clarify states' authority to order retail electric competition and the rights of consumers in open states to aggregate their purchases. The bill protects state public purpose programs, increases criminal penalties for Federal Power Act violations and expands FERC refund authority.

In addition to these provisions, regulatory transparency and access to books and records provide the most important consumer protections. Under the PUHCA repeal section of this bill, both FERC and state commissions have explicit statutory authority to review the books and records of every utility holding company, not just the limited number of companies currently covered under PUHCA.

It's probably not often that private sector witnesses come before this committee and ask you to pass legislation increasing the ability of regulators to look at their books. But regulatory transparency, protection against cross-subsidization and consumer protection all make sense. Laws that arbitrarily keep investment and investors out of critical industries don't.

Mr. Chairman, there's one other topic I'd like to address before I conclude—the problems at Enron. No one should make the Enron situation an energy issue—it is an issue of poor investments and the misuse of accounting. Energy markets are functioning fine without Enron.

One of the untold stories of the Enron collapse is how little impact this has had on the regulated entities that are the direct providers of most electricity and natural gas to consumers. Most regulated entities took steps to limit their exposure to Enron in the weeks leading up to the company's collapse. While lenders and traders face liabilities as a result of their relationships with Enron, utilities managed their potential exposure well.

I find it particularly ironic that some are trying to claim that the collapse of Enron shows that we shouldn't repeal PUHCA. For years, Enron was one of the most vocal opponents of PUHCA repeal, working to keep highly regulated, established, asset-backed companies out of emerging energy markets.

Enron is not, and never had been, subject to PUHCA. And, for the most part, because of the nature of its business, it was not subject to many forms of state and federal regulation to which public utilities would continue to be subject under this bill.

State and federal regulators possess extensive authority over utility companies in terms of the rates of return on investment that they allow. State regulators have complete authority over what costs they will allow to be recovered in rates, and the language of this bill clarifies that they have a federal right to review the books and records of any utility under their jurisdiction.

This Committee has a great history on matters of oversight and investigations, and I applaud Chairman Tauzin for announcing his intention to hold hearings on this matter. I also believe Representative Markey has raised valid questions about oversight of electricity trading markets that deserve the Committee's attention.

I would recommend focusing on the following areas:

1) Did this situation involve abusive accounting practices?
2) Did outside auditors meet their professional obligations?
3) Were both the letter and intent of the law followed?
4) Is there adequate oversight of the trading side of the energy business and what federal agency should have primary jurisdiction over these markets?

I believe the Committee should review these questions thoroughly and ensure that measures to address any abuses are implemented properly. Given the scale of this situation, I believe that if legislation is needed, there will be adequate incentive for Congress to act. The Subcommittee should not, however, turn away from the task of doing its part to aid the economic recovery by modernizing our electricity laws and infrastructure because of problems at one company, no matter how high profile.

Thank you and I'll be happy to answer any questions you may have.

Mr. LARGENT [presiding]. Thank you, Mr. Sokol.

The Chair recognizes Mr. Richardson for his statement.

STATEMENT OF ALAN H. RICHARDSON

Mr. RICHARDSON. Thank you, Mr. Chairman. It is a pleasure to be here today, and I appreciate the opportunity to testify. I am Alan Richardson, President and CEO of the American Public Power Association.

We have testified before this committee a number of times myself, and managers of individual public power systems. For the most part, public power systems are net deficient in generation.

We are dependent upon an effectively competitive wholesale market. Again for the most part, Public Power Systems are net deficient in transmission. Most of us are transmission dependent utilities.

Even those with significant transmission facilities of their own are dependent upon others for additional transmission services. We have a vested interest in making sure that the wholesale market is really competitive, effectively competitive, and that it benefits the interests of our utilities, the interests of our communities, and

the interests of our consumers, and in fact the interest of all electric consumers across the country.

We have been strong proponents of effective wholesale competition and proponents of Federal legislation throughout these long debates over industry restriction that have proceeded for the past 5 years.

There have been a number of very significant events that have occurred in the last couple of years, bookmarked by the bankruptcy of PG&E at the beginning or the end of last year, and the bankruptcy of Enron at the beginning of this year, or at the very end of this year.

And then a series of events in between, including a change in leadership and direction of the Federal Energy Regulatory Commission, and a real commitment by current Commissioners to try to improve the situation in the wholesale power market.

They are taking a number of steps that we find very appropriate, and there are things that we thought that the Commission should have been doing in the past, and they are the kinds of things that we have been encouraging Congress to address because of the reluctance of the Commission to act on their own behalf.

So in many cases we believe that a number of things that we have been endorsing for Federal legislation are less necessary today than they have been in the past, and we believe that the Commission is on the right track and proceeding to put right things in the wholesale power market arena.

And so for that reason, we would urge some caution in moving forward in some of these areas. Let me address our primary concerns with respect to this legislation, and focus on those rather than all parts of the legislation, and then answer questions later in this hearing.

We oppose the repeal of the FERC merger review authority in this regard, and we support the position of the administration to preserve this authority, and in fact we would like to see it expanded to deal with the mergers of holding companies and to deal with the consolidation and the acquisition of generation facilities.

And in fact as we have advocated for a considerable period of time, we believe that the condition or the test that the Commission should use is not one of whether mergers are consistent with the public interest, but in fact whether mergers promote the public interest and promote competition.

Every merger takes a competitor out of the marketplace, and it can have significant adverse consequences for competition, and we believe that this authority should remain in the hands of the Commission.

We oppose the repeal of the Public Utility Holding Company Act, and at the present time we believe that the Act has provided great stability and financial structure to this industry.

In this period of turmoil, we believe that it would be inappropriate to repeal the act at this time. Further, we believe that it would be inappropriate to repeal the Act until we are clear and confident that we have created a market structure that can sustain competition over time.

The Holding Company Act deals not only with structure, but with protection of consumers from various abuses, and to the ex-

tent that those authorities are eliminated, additional authorities should be given to the Federal Energy Regulatory Commission to deal with problems of market power abuses in the new marketplace.

We oppose the provisions regarding the regional transmission organizations, and in this regard I believe we are consistent with the views that have been expressed to this committee yesterday by members of the Federal Energy Regulatory Commission.

This is a very prescriptive provision, and today more than ever I believe the Commission needs the flexibility to deal with changing circumstances, and this provision in our view reduces that flexibility and does not enhance it.

And for this reason, as well as for the fact that this provision captures public power systems as a blanket requirement for participation in regional transmission organizations, we do not believe that it is appropriate.

We believe that the Commission has adequate authority under the present laws to deal with these issues. We oppose the new standard on the stranded costs provision that would apply only to newly created, publicly owned, electric utilities.

The States are fully capable of handling stranded cost provisions when communities desire to establish their own electric utility system, and in the event that they are not, there is a backstop with the Federal Energy Regulatory Commission under Order 888.

We do not believe that an additional backstop created by this legislation is necessary, and further the formula that is proposed in here for stranded cost recovery is so onerous that it will make the creation of new publicly owned utilities virtually uneconomic.

The bill requires FERC to consider incentive rates for new transmission provisions, and new transmission facilities. We do not believe that this is necessary. We believe that the Commission has the authority and the ability under the current standard of just and reasonable rates, which is a zone, and not a single rate, to provide incentives that will attract capital.

We do not think that the problems in investing in transmission have been due to a lack of capital, but they have been due to other problems that go beyond that. Finally, the legislation subjects wholesale power rates, and rates for transmission services provided by publicly owned utilities to private power companies to after the fact regulatory proceedings.

And while we support the FERC-lite provisions that were mentioned a minute ago about Mr. Sokol, this provision in the bill in effect undoes that FERC like compromise. We do not think it is necessary and we oppose that.

We believe that the Commission is moving in the right direction in terms of rectifying many of the serious problems in the wholesale power market. It is pushing utilities toward RTO participation, but it is acting within its statutory limitations.

It is addressing the issue of when and under what circumstances jurisdictional utilities may sell power at market-based rates. It is establishing market monitoring and taking steps to ensure greater transparency of information.

It is doing all of these things under the authority that it currently has, and we do not believe that the authority should be cir-

cumscribed, nor do we think that its flexibility to deal with these issues should be limited.

Thank you for the opportunity to testify, Mr. Chairman, and it is a pleasure, Mr. Largent, to appear before you, and perhaps my final time before you. So, it is a pleasure to be here today.

[The prepared statement of Alan H. Richardson follows:]

PREPARED STATEMENT OF ALAN H. RICHARDSON, PRESIDENT AND CEO, AMERICAN PUBLIC POWER ASSOCIATION

Mr. Chairman and members of the subcommittee, my name is Alan Richardsonand I am the President and Chief Executive Officer of the American Public Power Association (APPA). Thank you for the opportunity to appear before you today to discuss APPA's views on H.R. 3406, the Electricity Supply and Transmission Act. APPA represents the interests of more than 2000 publicly owned electric utility systems across the country, serving approximately 40 million citizens. APPA member utilities include state public power agencies and municipal electric utilities that serve some of the nation's largest cities. However, the vast majority of these publicly owned electric utilities serve small and medium-sized communities in 49 states, all but Hawaii. In fact, 75 percent of our members are located in cities with populations of 10,000 people or less. Further, most publicly owned utilities are not generation self-sufficient but depend on wholesale power purchases to meet the retail loads of the communities they serve. Competitive wholesale markets are in our interest and we have a very long record in support of legislative and regulatory initiatives that promote greater real competition in these markets. Finally, almost without exception, publicly owned utilities depend on others for transmission. Fair terms for transmission access at just, reasonable and non-discriminatory rates have always been critically important for public power

Public power systems' first and only purpose is to provide reliable, efficient service to their local customers at the lowest possible cost. Publicly owned utilities also have an obligation to serve the electricity needs of their customers and they have maintained that obligation, even in states that have introduced retail competition. And, because they are governed democratically through their state and local government structures, public power systems operate in the sunshine, subject to open meeting laws, public record laws and conflict of interest rules.

For decades, APPA has supported legislative efforts to make the wholesale electric market more competitive. APPA was one of the major supporters of the transmission access provisions of the Energy Policy Act of 1992. On numerous occasions over the past few years, we have testified in support of the enactment of federal legislation that promotes competition, increases reliability, expands the transmission system, addresses market power in generation and transmission, and eliminates tax-related impediments to competition for municipal utilities.

These past few years, and especially the past two years, have been a period of rapid and dramatic change in our industry. This change has occurred in federal and state policies on electricity competition and regulation; in the wholesale and retail markets for electricity; and in the minds and attitudes of consumers. The lessons learned from these experiences should serve to guide this subcommittee and other policy makers on any additional changes to the industry that may be necessary.

The goal of Federal restructuring legislation should be to promote competition in the wholesale electric market for the benefit of consumers. There are several fundamental elements necessary for real competition to exist and be sustained over time. These include: ease of entry to and exit from the market; availability and transparency of market data; a sufficient number of buyers and sellers; and effective controls to prevent the abuse of market power where possible and remedy abuses when discovered. 1H.R. 3406 is, presumably, a bill "to benefit consumers and enhance the Nation's energy security by removing barriers to the development of competitive markets for electric power . . ." H.R. 3406 falls far short of these lofty goals because it fails to encourage the creation of an environment that is consistent with the fundamental elements that are prerequisites for competition. Indeed, H.R. 3406 represents a significant step in the opposite direction. In its present form, this bill will neither benefit consumers nor remove barriers to competition. It does just the opposite.

Briefly stated, we oppose H.R. 3406 in its present form because:

1. It eliminates FERC merger review authority. This review is not redundant with existing authority under the antitrust laws exercised by the Department of Justice and the Federal Trade Commission. Unrestrained and unexamined mergers

can clearly be a barrier to the development of competitive markets. Every merger eliminates at least one competitor from the market and many mergers are pursued precisely for this reason. FERC's authority to review proposed mergers should be expanded to include mergers of holding companies, transfers of generation facilities, and consolidation of electric and natural gas companies. FERC should also retain present authority to be used as necessary to promote competition, including the authority to condition mergers and grant permission to sell power at market based rates on membership in FERC approved regional transmission organizations.

2. It repeals the Public Utility Holding Company Act, an important consumer protection statute, without enhancing FERC's authority to deal with market power problems. All agree that PUHCA repeal will result in new mergers and further consolidation within the electric utility industry. . . . Prescriptive that they severely limit FERC's discretion with respect to such critical issues as appropriate size, scope and function. Further, H.R. 3406 would prohibit FERC from conditioning approval of such things as sales of power at market based rates on RTO membership.
3. It imposes almost insurmountable financial obstacles on communities that want to create their own locally owned and publicly controlled electric utility by dictating the formula that must be used to calculate "stranded costs" incurred by the incumbent utility. In calculating stranded costs, FERC must use as a benchmark factors that existed in 1996, factors that are not likely to bear any relationship to conditions that exist today or in the future, not the least of which is the underlying historically installed generation capacity situation. The intent of this section is clear—to prevent the creation of new public power systems whether or not they advance competition, or promote lower rates and better service for America's electric consumers.
4. It promotes incentive rates for transmission service that are unnecessary, inconsistent with the Commission's responsibilities to ensure only just and reasonable rates for transmission, and will certainly lead to higher costs for consumers.
5. It subjects wholesale power sales and rates charged for transmission access by publicly owned utilities to private power companies to after-the-fact regulatory proceedings by FERC for no legitimate public purpose.

Due to a number of recent developments, we recommend that the subcommittee defer action on comprehensive restructuring legislation at this time. The number of issues that now require congressional action has greatly decreased. This is due in large part to the willingness of the current members of FERC to exercise authorities already available to them under the Federal Power Act. We believe the current members of FERC have a very clear vision as to what is necessary to promote real competition and they recognize that competition is a means to promote the interests of consumers and not an end in itself. FERC has set out, and begun to act on, an impressive set of initiatives to establish effective wholesale competition. And while public power systems have concerns about aspects of some of those initiatives, on the whole, we applaud the FERC for taking action to deal with serious problems in the wholesale markets.

Much of what APPA and others have advocated in federal legislation debates prior to these actions by the FERC was mainly necessary in order to direct an unwilling FERC to use its existing authority appropriately. APPA has consistently supported pro-competitive legislative proposals that would both direct the Commission to act, and provide it with the political support to do so. Thus, in light of FERC's new direction, it seems prudent to allow FERC to develop and implement these stated initiatives without overly prescriptive statutory changes imposed by Congress.

Any legislation that may ultimately be approved by Congress must first do no harm to consumers and should, as mentioned above, build on the valuable lessons learned in the recent past. For example, we learned from the Western electricity crisis that premature decisions to allow market-based rates, based on outdated and inadequate analytical tools and faulty assumptions, will have significant negative consequences for consumers. FERC is undertaking such a review at the present time. An important tool at its disposal is to condition market based rate approval on participation in an approved RTO. Provisions of H.R. 3406 would eliminate this authority. If Congress is serious about promoting competition, it should applaud FERC's recent initiatives, not advance proposals that undermine them. The collapse of Enron teaches us that market transparency and full access to all books, records, and other pertinent information by regulators is essential, although there may be many other lessons yet to be learned as the Enron story unfolds.

We also learned that local control of public power systems continues to work extremely well. Publicly owned utilities in California and throughout the nation have retained their obligation to serve all their customers and continue to meet that obligation with quality, reliable service at cost-based rates. About the only thing California did right was preserve local control of public power. Public power systems have retained their generation assets and are actively planning and building to bring additional resources on line, including significant investments in renewable and distributed generation projects. Public power is also working to add additional transmission capacity to the grid, particularly in key constrained areas. For example, a public power entity, the Transmission Agency of Northern California, is a major participant in the project to upgrade California's infamous Path 15. Despite these proven benefits of public power, and its role in promoting both infrastructure development and greater competition, H.R. 3406 would create a nearly insurmountable financial barrier to the creation of new publicly owned electric utilities.

Following, then, are comments on certain specific provisions of H.R. 3406, based on the foregoing discussion. As delineated below, APPA has significant concerns about major elements of the bill and some additional concerns regarding several other provisions. There are also several provisions in the bill that APPA supports and those are discussed below as well. The positive provisions of the bill, however, do not offset its significant negative impacts.

MAJOR CONCERNS

Section 141—Repeal of certain provisions of the Federal Power Act regarding disposition of property, consolidation, and purchase of securities

This section repeals Section 203 of the Federal Power Act, thereby completely eliminating FERC's authority to review, approve and condition utility mergers and asset disposition. Accelerating consolidation in the electricity industry already threatens competition and consumers' interests. Not only does H.R. 3406 fail to include any provisions to address generation market power, as discussed below, but inclusion of this provision actually makes it more likely that large generation companies will get larger and be able to exercise market power. Thus, APPA strongly opposes this section and urges its deletion.

Instead, APPA has consistently urged adoption of a higher standard that would condition merger approval on an affirmative finding that the proposed merger will promote the public interest, as opposed to the current standard that only requires the merger to be consistent with the public interest. In addition, FERC's merger authority needs to be clarified and expanded to cover mergers of utility holding companies as well as the disposition of generation assets by jurisdictional utilities and the acquisition of natural gas companies. FERC lacks the clear authority to review the former. While APPA believes FERC has the authority and responsibility to review the latter, it has recently declined to do so. Removal of FERC's merger authority will lead to an increasing amount of mergers resulting in greater consolidation of market power that will ultimately undermine competition.

Title I—Subtitle B Provisions Regarding PUHCA

APPA continues to oppose repeal of the Public Utility Holding Company Act (PUHCA) unless FERC is provided clear authority and support to protect consumers against the abuse of generation market power. PUHCA has been, and continues to be, an important part of the structure of the electric utility industry by defining the permissible structures of holding company formation and ensuring effective state and federal regulation of these companies in order to protect consumers, investors and the public interest. PUHCA is also the only federal statute that protects against the abuse of cross-subsidization of affiliated ventures by regulated utility operations. Cross-subsidization destroys true competition in unregulated markets and overcharges ratepayers. The repeal of PUHCA should be considered with great caution.

Unfortunately, H. R. 3406 simply repeals PUHCA without any offsetting provisions to protect consumers against generation market power or cross-subsidization in company affiliate transactions. At a minimum, Section 113 should be amended to allow federal and state regulators access to a broader range of pertinent information, rather than the proposed limitation of records relating to "costs". In addition, APPA suggests that FERC, perhaps in consultation with the Federal Trade Commission and the Department of Justice, should retain the authority to require the restructuring of utility holding companies where its is demonstrated that the holding company operated in a manner inconsistent with the interests of electric consumers.

Members of the subcommittee may have heard arguments from those in favor of repealing PUHCA asserting that the Act has inhibited investment in new genera-

tion. PUHCA does not, in fact, inhibit investment in either generation or transmission. Under 1992 amendments to PUHCA, investments in generation plants can be made by any party in any location throughout the United States. In addition, if regulation under PUHCA is such a detriment to the ability of a private company to grow then why has the number of holding companies regulated by the Securities and Exchange Commission (SEC) increased. In fact, in the past eight years both the number of registered holding companies and the number of electric customers served by registered holding company subsidiaries has more than doubled.

Title VII—Investigation and Correction of Anti Competitive Conduct

APPA is also strongly opposed to this title's extension of FERC jurisdiction over public power systems. This encroachment on local authority is neither prudent nor warranted. Public power systems have been regulated differently under federal law for more than 66 years. This is neither an accident nor an oversight, but rather good public policy that recognizes that public power systems operate in the public interest and are regulated at the local level. Local elected officials oversee public power systems across the country to ensure consumers continue to receive low-cost, reliable electricity from their local providers.

Except for a few isolated examples, public power systems do not have surplus electricity to sell. These systems do not represent a significant presence by sellers in the wholesale markets, and public power is, and will continue to be, net purchasers of electricity. The limited volume of surplus energy from public power systems precludes their ability to set a market-clearing price—public power systems are price makers, not price takers. There is no policy justification for reversing decades of effective, local authority.

In addition, Section 702 undermines the compromise reached in portions of Section 201, commonly referred to as "FERC-lite", for regulation of public power transmission facilities. Contrary to the intent of FERC-lite, Section 702 allows FERC to retroactively set rates for transmission service.

Section 202—Regional Transmission Organizations

APPA believes that Section 202 is unnecessary and in fact counter-productive. It should be deleted from the bill. This section proposes modification of FERC's RTO authority as set forth in Order 2000. It would require all transmission owners, including public power systems, to form or participate in an RTO within 12 months, and make certain other changes to characteristics of RTOs as set out in the Order. APPA agrees that the single most important step that can be taken to achieve the goal of a robust transmission system is the establishment of properly configured, truly independent RTOs that have primary planning responsibility for the regional grids under their control. APPA continues to support FERC's existing authority to establish and require public utility participation in strong, truly independent RTOs in order to facilitate the development of vigorously competitive retail markets.

FERC has maintained in Order 2000 and subsequent orders and proceedings, that it has the authority to order RTO participation by jurisdictional utilities to remedy undue discrimination or facilitate competition. Congress should do nothing to statutorily interfere with FERC's development of RTOs or attempt to prescribe specific elements and deadlines.

Section 202 represents a significant and inappropriate contraction of FERC's existing authority and creates opportunities that will permit potential RTO participants to delay RTO formation (evidentiary hearings before FERC, FERC decisions to be approved on appeal to the courts only if supported by a "preponderance of the evidence" as opposed to the customary standard of "substantial evidence"). The section fails to guarantee that RTOs created under this new authority will in fact promote effective competition, and because it is so prescriptive, it will virtually eliminate the opportunity for FERC to make mid-course corrections as experience is gained regarding the creation, operation and appropriate functions of RTOs. FERC has substantial authority under the Federal Power Act to promote the creation of RTOs and to determine the appropriate size, scope and functions to be performed, including the authority to condition approval of proposed mergers or market based rate sales on membership in a FERC-approved RTO. Section 202 expressly eliminates this authority.

FERC must be allowed to proceed so that industry will have the stability that regulatory certainty in this area will provide and regulators will have the flexibility they need to make adaptations as necessary. In addition, it is not necessary for Congress to expand FERC's authority to order participation by public power systems, public power will voluntarily join RTOs that are properly configured and provide benefits for public power customers.

Section 401—Sustainable Transmission Networks Rulemaking

Section 401 directs FERC to conduct a rulemaking on incentive and performance-based transmission rates. APPA is strongly opposed to this section because it is unnecessary and would lead to higher transmission rates. We therefore urge its' deletion. FERC, under the Federal Power Act and Order 888, already has sufficient authority and flexibility to design transmission rates to "promote economically efficient transmission and generation of electricity." These rates remain subject to the "just, reasonable, and not unduly discriminatory or preferential" standard that has been the hallmark of FERC ratemaking authority for decades. (This standard was recently affirmed by FERC in Order 2000 on RTOs). The language in this section would have the effect of requiring FERC to undermine that standard.

Proponents of this language have asserted that incentive pricing is necessary in order to raise the capital needed for investments in new transmission facilities. They argue that incentives are justified because transmission investment is risky. This is clearly not the case. Developing new transmission facilities is clearly a difficult task. There are substantial obstacles in the siting and permitting process. Rights of way may be denied for parochial reasons with no consideration given to broader public interest considerations. Current transmission owners may have incentives to delay grid expansion in order to protect sales of their own generation. These are not problems that can be overcome simply by throwing money at them. The fact is, transmission construction and operation is not inherently risky. Transmission is the prototypical low risk, traditional, regulated utility investment that has been very successful in attracting capital at reasonable, regulated rates of return. A good example of this is the recent Fitch Report on the new American Transmission Company in Wisconsin, a transco that began operations on January 1, 2001. As the report points out, over 95% of this transmission-only company's revenue requirement is guaranteed by recovery from its firm, network customers regardless of changes in load, weather, etc.

The obstacle to new transmission is, in fact, the lack of siting approvals, not the lack of available capital. Thus, this provision will do nothing to cause the construction of additional transmission facilities or add capacity to existing lines. Moreover, APPA believes that incentive rates will undoubtedly lead to increases in overall transmission costs, which are decidedly not in the public interest.

OTHER CONCERNS WITH H.R. 3406

In addition to the major issues of concern identified above, APPA also has serious concerns with several other provisions in the bill as discussed below.

Section 201(a)(3)—Certain Wholesale Stranded Costs

This section would require FERC to impose wholesale stranded costs on cities and towns that municipalize their electric service, using a prescribed formula. That formula requires the calculation of wholesale stranded cost based on "a reasonable expectation period that is based on the weighted average remaining useful life of generation assets owned or power purchased under contract by the public utility and included in wholesale or retail rates in effect on July 9, 1996." The fact that these generation assets may have been sold, or the contracts may have been modified in the intervening years is irrelevant. Clearly, the only purpose of this language is to render municipalization cost prohibitive and thus deny cities and towns across the nation the fundamental right to determine whether they will offer electricity service themselves, or franchise that service to a private company. This is the antithesis of the "choice and competition" philosophy the U.S. Congress has espoused as justification for restructuring of the electric utility industry. Moreover, FERC currently has the authority to fairly decide wholesale stranded cost disputes on a case-by-case basis. Thus, this provision is unnecessary and APPA strongly urges that it be deleted.

Section 525—Direct Service Industries

These provisions direct the Bonneville Power Administration (BPA) to negotiate power sales contracts with all willing Northwest aluminum direct service industrial customers beyond the term of the currently effective BPA power supply contracts. This section would authorize the Department of Energy and not BPA to determine what constitutes a "reasonable level of federal firm power." The determination regarding reasonableness is to be based on an allocation of power "that will enable such customers to operate their facilities in the Pacific Northwest in an economic manner for the long term." It would appear that the interests of a few aluminum companies are to take precedence over all other consumers in the Pacific Northwest. It is inappropriate for Congress to legislatively interfere with the renewal of these contracts or to re-establish the situation where, due to wholesale price volatility,

these companies could, as they did in the recent past, make more money re-selling their BPA power than by producing aluminum.

Section 532—Wholesale Sales by Federal Power Marketing Administrations

This section states that all rates and charges for the sale of electric energy and capacity by Power Marketing Administrations (PMAs) shall be the lowest possible rates. Furthermore, the section asserts that charges to consumers will allow the recovery over a reasonable period of years, in accordance with sound business principles, of all costs incurred by the United States for the production of electric energy sold by a PMA, including repayment of the capital investment allocated to power and costs assigned by the Acts of Congress to power for repayment.

Section 532 is unnecessary and should be deleted. Existing criteria in federal law, going back to the Reclamation Project Act of 1939 and the Flood Control Act of 1944, for establishing PMA wholesale power rates is sufficient and appropriately balances the requirements to recover federal investments and maintain low electricity rates.

Section 533—Regulation of Federal Power Marketing Administration Transmission Systems

APPA is opposed to this section which would subject PMA transmission rates to full FERC jurisdiction, identical to that applied to "public utilities". APPA believes that the current system of regulating these rates, which recognizes the inherent differences between investor-owned utilities and federal entities, is sufficient to recover the federal government's costs and to protect consumers' interests.

Section 534—Accounting

Section 534 directs FERC to issue rules to ensure that PMAs utilize the same accounting principles and requirements that are applicable to public utilities, procedures for the filing of complaints with FERC to parties seeking to ensure compliance, and procedures to ensure the power generating agencies and PMAs maintain a consistent set of books and records for purpose of debt repayment.

This section is also unnecessary and should be deleted. Federal entities are different than "public utilities" in many ways, including their basic purposes and obligations as prescribed in federal law. This section would set up conflicts between those legally prescribed obligations that could increase electricity costs for consumers while providing no long-term benefit to the federal government.

Section 102—Federal Standards for State Net Metering Programs

These provisions require states, non-regulated electric utilities, and federal power marketing agencies to implement net metering programs that meet minimum federal standards—for renewable resources (up to 250 kilowatts). If a utility fails to implement a program within one year, then FERC establishes a program that the utility must implement. While there can be positive benefits to net metering, such as its potential to increase the use of renewable resources and provide generation alternatives, net metering is essentially a "retail" program and should be left to states and localities. Approximately half of the states already have some type of net metering program in the works. If net metering is to be included in a federal bill it should, at the minimum, grandfather existing state programs.

Section 103—Price-responsive Demand Programs

All utilities have demand reduction, load curtailment, and energy efficiency programs available now to their customers and public power systems in particular have been very responsive to customers in this regard. APPA believes such programs are best left to state and local entities, and this language is unnecessary. Moreover, this provision raises a question about whether it is appropriate for the agency that regulates wholesale power markets to be, in effect, a participant in those same markets.

PROVISIONS OF H.R. 3406 THAT APPA SUPPORTS

While APPA is opposed to the overall bill in its current form, there are several sections of the bill where APPA either supports the language as introduced, or supports the concept embodied in the provision and would seek certain modifications. These are discussed below:

Section 201(a)(2)—Open Access Transmission (FERC-Lite)

While public power systems with transmission facilities are not anxious to be subjected to FERC jurisdiction, the limited jurisdiction contained in this section of H. R 3406, known as FERC-lite, is an acceptable compromise and is consistent with APPA policy. In essence, FERC-lite would extend FERC jurisdiction to public, cooperative, and federal utilities with transmission facilities interconnected to the na-

tional grid. The FERC-lite language makes the important exception, however, that FERC would not be given the authority to set transmission rates for these non-jurisdictional transmitting utilities. Instead, FERC would determine whether the rates they charge to others are comparable to those they charge themselves. If there were discrepancies, FERC would remand the issue to the publicly owned utility. It is important to note that these provisions do not work unless accompanied by changes in the federal tax code that resolve the barriers posed by the private use limitations on tax-exempt bonds used to finance public power transmission facilities.

Title III—Transmission Reliability

APPA supports this title that represents one of the few matters relating to restructuring on which Congress could have the confidence to legislate. We appreciate the inclusion in H. R. 3406 of additional language suggested by the North American Electric Reliability Council and Chairman Barton's efforts towards creating a national electric reliability organization to set and enforce reliability standards, subject to FERC oversight.

Section 402—Transmission Siting

APPA also supports, in principle, the bill's approach to federal siting authority as outlined in section 402. APPA recognizes that backstop siting authority is a necessary tool to facilitate the siting of new transmission lines that are stymied by the current balkanized, state-by-state siting approval process. Transmission lines are necessary to support interstate commerce, as well as security interests, and thus a federal role in the siting of these lines is appropriate. APPA would strongly urge that every reasonable effort be made first at the local and state levels to resolve siting issues and that federal siting authority should only be used as a last resort.

Section 101—Interconnection

APPA generally supports the provisions in the draft given the preservation of appropriate local authority. We agree with calls for a more streamlined, uniform approach to distributed generation and the use of a standardized technical interconnection, but not at the expense of public health and safety, cost-shifting, and potential reliability problems. This is one of a number of issues, however, where legislation may not be necessary. FERC already has jurisdiction under Section 210 of the Federal Power Act (FPA) to order interconnection to any transmission facility. In addition, the IEEE may soon adopt an industry-wide interconnection standard that adequately preserves local (distribution) control, and FERC may soon adopt some standardized interconnection agreements that resolve most of the issues that have concerned the generator manufacturers and owners. The successful convergence of these events may obviate the need for Congress to act on this issue.

Title V, Subtitle A—Tennessee Valley Authority

This subtitle represents a previously developed consensus on the relevant issues among the various stakeholders, including in particular TVA's municipal utility distributors, TVA, and the congressional delegation representing TVA's service territory. APPA supports the efforts of its members in this region to modify provisions of existing law to promote overall goals of increased competition, better service and lower rates for customers served by TVA.

Title VI—Consumer Protections

Should restructuring legislation move forward, APPA supports the inclusion of the provisions in this title to further protect consumers. However, other provisions previously addressed, including the elimination of FERC merger review, incentive pricing for transmission, PUHCA repeal, and overly prescriptive provisions regarding RTO formation create significant risks for consumers that are not offset or overcome by these modest consumer protection provisions.

CONCLUSION

APPA opposes H. R. 3406 in its current form because so much of the bill is either unnecessary or contrary to the interests of consumers and the promotion of effective wholesale competition. Congress should either defer legislation and allow the FERC to continue to implement its stated objectives, or address a much narrower range of subjects necessary to fill in the gaps in federal oversight. In any event, it would be wise to heed the lessons learned over the recent past and avoid overly prescriptive changes in federal law.

Mr. LARGENT. Thank you, Mr. Richardson. Did you like the name of the bill? I am just looking for one thing.

Mr. RICHARDSON. Well, the name is quite nice. I am not sure that it lives up to its promise, sir.

Mr. LARGENT. Okay. Thank you, Mr. Richardson.

Mr. Johnston, we will let you collect yourself, and kind of come back to you at the end. We appreciate you being here.

Mr. JOHNSTON. Thank you.

Mr. LARGENT. And now we will recognize Mr. English.

STATEMENT OF GLENN ENGLISH

Mr. ENGLISH. Thank you very much, Mr. Largent. Let me start out by saying that I like the name of the bill. It is very nice, and I appreciate that. The last time that I testified here with regard to the draft legislation, I pointed out specific items that we had concern over.

Today what I would like to address is not so much the trees as much as the forest. I would like to step back and take a look at this bill. The Rural Electric Cooperatives who I represent, some 35 million consumers across this country, consumer-owned and not for profit organizations, have no issue with the objectives of this legislation.

I think we are certainly in accord with what the stated objectives of this legislation are. But sometimes things don't quite work the way that we say we would like for them to work out.

A number of years ago the State legislators in California, when they passed the restructuring bill, all thought that they were voting for cheaper power for their consumers.

They thought that this would be the results of the legislation that was passed. Well, obviously things didn't quite work out that way. The concerns that we have is that the stated objectives of this legislation don't square with what the legislative language says and what the legislation actually does.

I would suggest to you that instead of providing the Federal Energy Regulatory Commission with more authority, it actually restricts what the Federal Energy Regulatory Commission can do. It takes away power from what State Regulators can do in order to protect the public.

It makes it more difficult for the Federal Energy Regulatory Commission to deal with disasters such as what we had in California and less publicized disasters in Montana, and even in States that have been heralded as great success stories like Pennsylvania.

I might point out to you that not a single rural electric consumer in the State of Pennsylvania has had anyone who has offered them any choice in any type of competition whatsoever.

That is not what was stated and not what was promised when it took place. It certainly makes it much more difficult for the States to deal with protecting consumers and the local communities in those States over whom they have a responsibility and obligation to take care of.

The limitation on the Federal Government's ability to protect consumers and investors starts out with a repeal of the Public Utility Holding Company Act. Certainly that restricts the ability to deal with market power, and there is nothing in this legislation to take the place of that in protecting the consumers of this country,

as was the objective of the Public Utility Holding Company Act or is.

It repeals Section 203 of the Federal Power Act, taking away FERC's authority to review mergers and transfers, and the facilities again, and the ability to deal with a market power issue.

It includes four pages of detailed requirements for transmission rates, and narrowing FERCs authority to reject transmission rates that it believes are too high, and in fact requires the Federal Energy Regulatory Commission to pass rates that they consider to be unjust and unreasonable.

Nor does it take any of those excessive funds and require that those funds be used to build new transmission, which is purportedly the stated objective of this particular provision.

It includes 12 pages of detailed requirements for RTOs, restricting FERCs authority to guide the formation of RTOs in the public interest, and making it far more difficult for FERC to change course in response to the changes in technology or wholesale power markets.

It includes 21 pages of detailed requirements for interconnection standards, preempting the ongoing rulemaking and restricts FERCs ability to encourage new generation needed for a robust, wholesale energy market.

With regard to the restrictions on the State, Mr. Chairman, it Federalizes net metering, and preempting the net metering provisions that have already taken place in 34 States, as well as the deliberate decisions by many of these States that net metering has not been official to their communities.

It Federalizes the standards for interconnection for the distributed generation, preempting the interconnection provisions in several States, and the ongoing rulemaking that is taking place in many others.

It Federalizes the standards for retail rates for energy sold to consumers with their own generators, and evading the absolute core of State responsibilities. Now, this is not what I think the common perception of the members of this committee, and perhaps not even the authors of the legislation.

This is not what I think that they want. I think that we all want the same thing, but I do say that we have to address the legislative language to deal with this particular problem.

And even where it says that the authority is expanded, Mr. Chairman, that in and of itself is restrictive. In a provision, for instance, that requires the Federal Energy Regulatory Commission to regulate the smallest of those within the electric utility industry, that in itself limits the Federal Energy Regulatory Commission because it requires them to use very limited and scarce resources to focus their attention on those who have the least impact, and those where no complaint has been made, at the expense of focusing on those who are the largest, and those where the abuses have taken place, those where numerous complaints exist.

So I would simply suggest, Mr. Chairman, that we need to take a hard look at this legislation in general, and look at it from a distance. Let's make sure that the legislation language does indeed agree with what the promise is.

Let's make sure when the Members of this Congress vote for this legislation that they do have the hope and be able to have the opportunity, and realize the reality that this legislation accomplishes what it promises. Thank you very much, Mr. Chairman.

[The prepared statement of Glenn English follows:]

PREPARED STATEMENT OF GLENN ENGLISH, CHIEF EXECUTIVE OFFICER, NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION

INTRODUCTION

Chairman Barton and Members of the Subcommittee, I appreciate this opportunity to continue our dialogue on the restructuring of the electric utility industry. For the record, I am Glenn English, CEO of the National Rural Electric Cooperative Association, the Washington-based association of the nation's nearly 1,000 consumer-owned, not for profit electric cooperatives.

These cooperatives are locally governed by boards elected by their consumer owners, are based in the communities they serve and provide electric service in 46 states. The 35 million consumers served by these community-based systems continue to have a strong interest in the Committee's activities with regard to restructuring of the industry.

Electric cooperatives comprise a unique component of the industry. Consumer-owned, consumer-directed electric cooperatives provide their member-consumers the opportunity to exercise control over their own energy destiny. As the electric utility industry restructures, the electric cooperative will be an increasingly important option for consumers seeking to protect themselves from the uncertainties and risks of the market. I would like to thank you, Mr. Chairman, and Members of the Committee for your receptiveness to the concerns and viewpoints of electric cooperatives.

DISTRIBUTION AND RETAIL ISSUES

Title I of H.R. 3406 would: (a) grant FERC the responsibility for establishing standards for the interconnection of distributed generation to the distribution and transmission systems; (b) mandate net metering for some consumer-owned generation; (c) establish principles for setting rates for retail energy service to consumers with distributed generation; and (d) grant FERC new authority to regulate demand-side management programs.

NRECA is pleased that the Chairman has narrowed the language on price-responsive demand programs since the September draft. The statement that FERC programs "shall not preempt or displace existing non-Federal price responsive demand programs" is critically important. Nevertheless, NRECA opposes the federalization of these issues for several reasons.

First, electric cooperatives own 44% of the nation's distribution system. Much of these distribution systems are located in rural areas where the population density is low, averaging less than 6 consumers per mile. As a result, the revenue generated in these areas is extremely low, averaging approximately $7,000 per mile. Net metering and distributed generation interconnection programs, for instance, if formulated and implemented without a strong sensitivity and appreciation for local conditions would lead to increased electricity costs for consumers in rural areas that could least afford to pay them.

Second, electric cooperatives have obtained $36.4 billion in RUS financing. As a result of this financing, RUS must approve the rates and practices of distribution cooperatives and cooperatives that own generation and transmission. Negawatt and net metering programs and distributed generation interconnection standards have a direct impact on these rates and practices; however, they are being federalized without any role for RUS. This will create significant problems for cooperatives, including increased costs and the risk of conflicting regulatory obligations.

Third, these issues have traditionally been the responsibility of states and local regulatory bodies for a very good reason: moving these issues to the federal level makes it more difficult, or in some cases impossible, for states and local regulators to protect the public interest. Policy decisions with respect to retail electric and distribution services can have a tremendous impact on local standards of living and economies. It is important, therefore, for state and local regulators to be able carefully to balance local interests and to craft tightly focussed regulations of retail electric and distribution services that meet local needs. Moving responsibility over these issues away from the local community to the federal level makes it less likely that regulatory decisions will reflect local needs or protect local interests. Moving responsibility over these issues away from the local community to the federal level also

makes it harder for utilities to provide reliable, universal electric service at a reasonable cost.

Moreover, NRECA does not believe that FERC has the experience or the resources to regulate effectively matters relating to retail electric or distribution services. Over more than 65 years, FERC and its predecessor, the Federal Power Commission (FPC), regulated wholesale sales and transmission service. FERC has never established technical standards for the interconnection of generation at the transmission levels, and it has never had any experience whatsoever regulating retail services or distribution systems. FERC does not employ today a single distribution engineer. Further, FERC is experiencing difficulty meeting its existing responsibilities today with its limited resources. Multiplying FERC's responsibilities by giving it new jurisdiction over retail and distribution services would spread FERC's limited resources even more thinly to the detriment of both wholesale and retail consumers.

NRECA was pleased to see in S. 1766, the Energy Policy Act of 2002, introduced by Senators Daschle and Bingaman, that at least some of these issues were left to the states. While S. 1766 expressed Congress' interest in distributed generation and similar retail policies, the bill left it to the states and local authorities under PURPA Title I to decide whether and how best to address those policies in light of local conditions and interests. NRECA believes that the PURPA Title I approach is the best way for Congress to address all of the retail issues on which it feels the need to speak.

If Congress insists on setting mandatory federal standards for distributed generation interconnection, net metering, and demand response programs, NRECA would be happy to work with the Chairman to adjust and focus the language to better serve consumer interests.

PUHCA, MARKET POWER, AND FERC MERGER REVIEW

NRECA believes that existing federal processes have been insufficient either to prevent concentration of market power or to protect consumers and competitors from the exercise of market power. Moreover, the proposal in Title I, Subtitle B, to repeal PUHCA, and the proposals in Sections 141 and 142 to repeal FERC's merger review authority and to eliminate NRC antitrust review would exacerbate existing market power problems by accelerating the process of consolidation in the electric industry and by making it more difficult for state and federal regulators effectively to police market behavior.

NRECA believes that if PUHCA is repealed, it should be replaced with modern legislation that takes a practical approach to controlling market power. Such legislation should provide regulators an array of tools that they can use to protect consumers and enhance competition in electric markets. In particular, Congress should:

- Impose on large electric utilities that seek to merge the burden of proof that their merger is consistent with the antitrust laws if the Federal Trade Commission (FTC) challenges the merger. The language would not change the burden of proof in criminal cases.
- Prohibit FERC from approving a merger involving a large electric utility if the merger would lessen competition or tend to create or perpetuate market power.
- Clarify, as does S. 1766, that FERC has jurisdiction to review mergers between holding companies.
- Clarify, as does S. 1766, that FERC has jurisdiction to review dispositions of generating facilities.
- Authorize the FERC to take action to remedy existing market power, including the authority to require a public utility with market power to divest generation assets.
- Require the FERC, the Department of Justice, and the FTC to conduct an interagency study of market power in the electric industry.
- Authorize the FERC to impose civil penalties on any public utility that exercises market power in violation of the Federal Power Act.

Only by including such provisions in restructuring legislation that repeals PUHCA can Congress protect markets and consumers from excessive consolidation in the electric industry and the exercise of undue market power.

PURPA

NRECA supports the Chairman's proposal, in Title I, Subtitle C, to repeal the mandatory purchase requirements in PURPA Section 210.

OPEN ACCESS AND FEDERAL JURISDICTION

NRECA opposes efforts to subject electric cooperatives to the jurisdiction of FERC. That expansion of jurisdiction would unnecessarily impose heavy financial burdens on electric cooperatives and their consumer-owners.

To put it in perspective, FERC should have a more significant role regulating larger electric utilities such as Entergy—whose subsidiaries own and operate more than 14,000 miles of transmission line and sell more than 97,000,000 MWH to more than 2,400,000 metered accounts—than it should have regulating Hickman-Fulton Counties Rural Electric Cooperative—which owns 1 mile of transmission line, and sells less than 120,000 MWH per year to fewer than 4,000 member-owners.

NRECA, sincerely appreciated the Chairman Barton's efforts in the 106th Congress to limit the expansion of FERC jurisdiction over electric cooperatives by applying the comparability standard over our transmission rate terms, and conditions, thereby establishing "FERC." While NRECA opposes the expansion of FERC jurisdiction, we remained neutral on H.R. 2944, the Electricity Competition and Reliability Act, that incorporated the comparability standard.

NRECA is disappointed that H.R. 3406 does not reflect a similar understanding of the cooperative difference. *Section 702 emasculates FERC lite.* While Section 201 creates the *veneer* of establishing the comparability standard as the basis for expanding FERC jurisdiction over transmission-owning utilities, Section 702 eviscerates the comparability concept. Under this section, rather than review cooperative transmission rates under a comparability standard, FERC would subject cooperative transmission rates to a full review under the just and reasonable standard if there were a complaint. Rather than remand rates to boards of directors elected by cooperatives member-consumers, FERC would set the rates itself at whatever level FERC considers appropriate.

In addition to emasculating FERC lite, Section 702 would also, for the first time, subject cooperatives' wholesale rates to FERC review and regulation. At a time when Congress and FERC are seeking to move towards a competitive wholesale market for electric energy, Section 702 would move in the opposite direction, increasing the regulatory burden on electric cooperatives that seek to sell power in the wholesale market. Yet, *electric cooperatives have not been part of the problem.* Not-for-profit electric cooperatives have not gamed markets, they have not abused consumers, and they have not exercised market power. It would be impossible for them to have done so. Cooperatives do not own enough generation and are not large enough players in electric markets to exercise market power. All together, electric cooperatives generate only about 5% of the electric power in the country, which is less than half of the power they need to serve their own consumers. All combined, electric cooperatives' sales to public utilities represent less than 1% of all sales in the wholesale market.

Nevertheless, NRECA would like to work further with the Chairman and the Committee to resolve any concerns they may have about FERC's role in a manner that minimizes the adverse impacts on cooperatives and their consumer-owners. In particular, NRECA would like to Committee to note that S. 1766 lacks any equivalent to Section 702, and that S. 1766 includes a "bright-line test" exempting small electric utilities from "FERC-lite" over transmission facilities without the need to engage in expensive litigation.

REGIONAL TRANSMISSION ORGANIZATIONS

NRECA supports the formation of large, independent Regional Transmission Organizations or RTOs for all transmission owners.

RTOs, if fully independent and properly designed and operated, can substantially mitigate the ability of transmission owners that also own generation to influence the market for electric energy and to potentially discriminate against competitors. Because an effective RTO can operate the transmission system on a regional basis to maximize efficiencies, it can also significantly improve reliability and reduce the potential for power market instability that can lead to price spikes.

NRECA believes, however, that the RTO provisions in H.R. 3406 have two serious shortcomings:

1. They fail to address certain issues that must be resolved before cooperatives can participate fully in RTOs; and
2. They sharply restrict FERC's authority to shape RTOs in a way that strengthens wholesale markets and protects consumers.

H.R. 3406 Must Enable Cooperatives to Join RTOs

NRECA has supported the formation of RTOs in a number of ways. NRECA submitted comments to the FERC in the rulemaking that resulted in Order No. 2000,

and, in fact, FERC adopted several of NRECA's recommendations. NRECA representatives attended each of the Commission's five regional collaborative meetings during 2000 and facilitated presentations made by individual cooperatives at those meetings. NRECA also successfully facilitated voluntary RTO informational filings by cooperatives even though the Commission's regulations did not require most cooperatives to make such filings. Finally, NRECA and cooperatives in the southeastern United States have been very active in the ongoing FERC mediation that is seeking to establish a single, large Southeast RTO.

For cooperatives to fully participate in RTOs as they clearly wish to do, and in order for properly formed RTOs to develop, the following issues are of critical importance and must be addressed by H.R. 3406:

Full Recovery of Transmission Revenue Requirements. Transmission-owning cooperatives must obtain full, immediate recovery of their revenue requirements from an RTO if they agree to commit their facilities to the functional control of that RTO, as contemplated by Order No. 2000.

Comparable Inclusion of Transmission Facilities. Some transmission-owning cooperatives have had difficulty getting their transmission facilities accepted for operation/cost recovery by a future RTO on the same basis as investor-owned utilities during the RTO formation process. Those IOUs opposing inclusion of cooperative transmission facilities point to the radial, load serving nature of these facilities as a reason for excluding them, overlooking the fact that they own comparable facilities that are included in their FERC-regulated transmission revenue requirements. Cooperatives therefore favor the use of a single, consistent standard to govern the RTO's functional control of all transmission facilities, regardless of the owner.

Grandfathered Contracts. Many cooperatives have substantial contractual arrangements with neighboring transmission providers. These contracts take many forms: some are among joint transmission owners, others deal with provision of both generation and transmission, and some are transmission-only agreements (both pre- and post-Order No. 888). Whatever their content and form, these contracts are vital to sustaining the cooperative's ability to provide on-going service to their own member-owners. Transmission-owning cooperatives will not be able to join an RTO unless they have assurances that such contractual rights will not be severed without their consent. Similarly, transmission-dependent cooperatives cannot lose access to the transmission facilities needed to serve their member loads.

Regulation by the Rural Utilities Service. Many cooperatives have substantial loans from, and, as a result, are substantially regulated by the Rural Utilities Service (RUS) of the U.S. Department of Agriculture. The Commission must take RUS regulation into account and coordinate with RUS to ensure that when cooperatives seek to join RTOs, inconsistent, inefficient regulation of cooperatives by these two federal agencies does not occur.

85-15 Revenue Test. Cooperatives lose their tax-exempt status when more than 15 percent of their revenue is received from nonmembers. The Internal Revenue Service (IRS) has not clarified that, when a cooperative joins an RTO, the revenues received by the cooperative from the RTO will not be deemed to be nonmember income for purposes of the 85-15 revenue test. Congress must ensure that cooperatives can join RTOs without unintentionally violating their current not-for-profit tax status. NRECA appreciates the Chairman's effort to address the 85-15 issue in the September 21 discussion draft. That language, however, is inadequate to solve the problem and permit cooperatives to participate in RTOs. Since the September 21 discussion draft addresses tax issues, it should incorporate the provisions in H.R. 1601.

Cost Shifting. RTO transmission rates and tariffs should (a) mitigate cost shifting and take into account the specific needs and characteristics of each affected region, including costs of operation, debt, and other expenses; (b) use the same effective return-on-investment to all participating transmission owners; and (c) recognize the goal of establishing a single non-pancaked rate structure applicable to all customers.

RTO Market Power. As transmission service remains a monopoly, and as individual RTOs assume control of larger transmission systems than individual transmitting utility owners, RTOs will possess unprecedented market power. In this context, a badly governed and operated RTO may be worse than no RTO at all. Thus, the monopoly status of an independent RTO must be acknowledged at the outset, and the RTO's transmission rate structure and associated cost-of-service should be developed using traditional cost-of-service ratemaking principles. RTOs should not be eligible for "incentive ratemaking," "performance-based ratemaking" or "light-handed regulation" that would have the effect of increasing rates to transmission customers without concomitant benefits or reducing independent regulatory oversight of such an RTO's activities.

Collaborative Process. The Commission has sought to encourage RTO forming public utilities to actively collaborate with cooperatives in order to accommodate

their needs as consumer-owned entities. Unfortunately, in numerous instances collaboration has been nothing more than a thinly disguised effort of saying, "take it or leave it." For cooperatives to effectively join RTOs, public utilities must be required to meaningfully collaborate with cooperatives beginning with the earliest stages of RTO formation efforts. The Commission should not fail to act when informed of RTO formation efforts that exclude cooperative participation.

NRECA would be happy to work with the Chairman and the Committee to draft language that addresses these concerns.

H.R. 3406 Should Not Handcuff FERC

In a number of ongoing proceedings, FERC is now actively developing an RTO policy intended to enhance wholesale electric markets and protect the public interest. Congress should not interfere with that process with overly detailed and prescriptive legislative language or by creating new procedural and substantive hurdles for FERC to jump. Section 202 of H.R. 3406 suffers from both failings.

First, Section 202 reads far more like a regulation than a statute. It includes detailed standards for RTOs that track many of the concepts included in FERC's Order 2000. As a result, it sets in stone concepts that are—and should be—in a state of flux. None of us yet knows what the wholesale markets will look like when the transition to competitive markets is complete. We all continue to learn what approaches are most likely to support a robust wholesale market and what approaches hinder the development of that market. Congress should not freeze the process of experimentation now. Congress should not deprive FERC of the flexibility it needs to respond to changing circumstances and new information. Otherwise Congress will likely stunt the formation of wholesale markets and freeze in place inefficiencies and inequities.

Moreover, while Section 202 includes many of the provisions of Order 2000, a careful reading indicates that it is not a faithful recreation of the Order 2000 standards. Instead, it appears there are several "strategic" absences from the requirements of Order 2000. As a result, if FERC were required to approve any RTO that met these incomplete standards, we could see many RTOs that are not independent, that do not have adequate size or scope, that do not reflect the infrastructure needs of the developing regional wholesale markets. Even if these holes in the statutory standards were not intentional, they reflect the danger of being overly specific and prescriptive in statutory language.

Finally, Section 202 imposes new procedural requirements on FERC and grants parties before FERC new appeal remedies that they do not have in other contexts. The combined effect of these new procedures and new remedies makes it far more difficult for FERC to meet its statutory obligation to protect the public interest. Congress should not interfere in this manner. FERC's existing procedures and appeal processes are adequate in other contexts and should not be changed for the limited benefit of transmission owners seeking to retail their market power after joining RTOs.

ELECTRIC RELIABILITY

NRECA supports the reliability language § 301 of H.R. 3406. That language would require FERC to approve a new North American Electric Reliability Organization that would have the power to ensure the reliable operation of the interstate bulk transmission grid. NRECA believes that similar legislation needs to be enacted as soon as possible.

NRECA opposes a competing proposal that would grant authority over reliability directly to FERC. The Commission lacks the expertise or the resources to address reliability on its own. There are questions whether it has been able to handle adequately its existing mandate to regulate wholesale markets. Responsibility for the reliability of the nation's grid would strain its existing staff even further. On the other hand, while stronger enforcement authority is needed, there is no question that NERC has done an admirable job of setting reliability standards. Congress should not reject an industry-based model that has worked extremely well for over 20 years.

TRANSMISSION INFRASTRUCTURE

North America needs the electric transmission equivalent of the interstate highway system. The current transmission system cannot reliably handle the dramatic increase in transactions since the enactment of the 1992 Energy Policy Act. Transmission deficiencies are contributing to wholesale and retail electric market failures that are harming consumers.

For the following reasons, NRECA does not believe that these problems can be solved by offering utilities high incentive transmission rates or other financial incentives to build transmission.

- *FERC's Existing Authority.* FERC already has the authority to establish incentive transmission rates. FERC issued a policy statement in 1994 that would permit "more flexibility to utilities to file innovative pricing proposals . . ." In Order 2000, FERC stated that it was "critically important for RTOs [regional transmission organizations] to develop ratemaking practices that . . . provide incentives for transmission owning utilities to efficiently operate and invest in their systems." [1] In testimony before the Energy and Air Quality Subcommittee on September 20, 2001, Deputy Secretary of Energy Frank Blake stated that "FERC has great flexibility under current law to set transmission rates at a level to attract investment." Since FERC has existing ratemaking authority to approve incentive transmission rates, legislative language is unnecessary.
- *Higher Electricity Prices for Consumers.* Currently, FERC has wide discretion in determining whether a public utility's transmission rate is reasonable. Legislative language requiring FERC to approve incentive transmission rates is designed solely to handcuff FERC by curtailing its authority to reject unreasonably high transmission rates, resulting in higher electricity prices for consumers. Also, by limiting FERC's ability to reject unreasonable rates, Congress grants transmission owners the opportunity to gouge consumers with unreasonably high transmission rates.
- *The Investment Community Is Unconvinced.* During the July 26 hearing before the Energy and Air Quality Subcommittee, Thomas Lane, Managing Director in Goldman Sachs Energy and Power Group, responded to Member questions and stated that there is a role for transmission rates that include the more traditional return on investment of around 12%. Since Wall Street believes that investments will flow into the transmission sector based on the current rate structure, it is unnecessary to force FERC to rubber stamp unreasonable rates.
- *Lack of Newly Constructed Transmission.* Legislative language forcing FERC to approve incentive transmission rates will not automatically result in the construction of new transmission for two reasons. First, the language fails to guarantee that transmission facilities will, in fact, be built in exchange for FERC's approval of incentive rates. Second, the language would require FERC to approve incentive rates for the operation of *existing* transmission facilities. High rates of return associated with existing transmission facilities will act as disincentives to the construction of new transmission that is needed to support a robust wholesale market.
- *Impediment to Generation Markets.* The interstate transmission system should exist to enhance the competitive generation market not to balkanize it further. Any approach that allows individual companies with a financial interest in the energy market to control transmission would have the unwelcome effect of erecting tollgates on the interstate system, thereby narrowing generation markets and protecting the existing power of local generators.

NRECA is concerned that the incentive approach would raise the rates of return and increase the costs for consumers, the intended beneficiaries of lower prices from competition. Also, FERC not only has that authority under existing law, but also has been encouraging utilities to propose innovative incentive-based rate designs for years.[2] In fact, FERC recently offered utilities a 300 basis-point increase in the rate of return and a 7-year recovery period if they would build transmission in the West by a stated deadline.

Given FERC's current efforts to encourage innovative rates, NRECA is concerned that legislative language establishing only incentive rates may handcuff FERC, limiting the agency's ratemaking discretion at a critical time in the development of a competitive industry.

As an option to legislating higher rates of return, NRECA believes Congress should lower the risk of building transmission. Congress should direct FERC to allow any entity that builds a qualifying transmission project to recover its costs. By reducing the risk, Congress could encourage institutional investors and others

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[1] FERC has also been encouraging the submission of incentive transmission rate proposals. According to FERC in Order 2000, "we have approved five ISOs [independent system operators] with innovative transmission pricing, but otherwise have received few innovative transmission pricing proposals."

[2] FERC's Pricing Policy for Transmission Services, 59 Fed. Reg. 55,031 (1994) (codified at 18 C.F.R. Part 2); Formation of Regional Transmission Organizations, 65 Fed. Reg. 810, 913 (2000) (codified at 18 C.F.R. Part 35).

looking for low risk investments invest in improvements to the nation's transmission grid.

To qualify for assured cost recovery, NRECA believes that transmission projects must:

- be identified through a regional joint-planning process that coordinates and has oversight for the reliable operation of the regional transmission system
- be constructed according to best engineering practices
- be operated by the relevant Regional Transmission Organization (RTO)
- offer service pursuant to traditional cost-of-service principles, with the cost-of-service analysis taking into account the low risk provided by FERC's obligation to assure cost recovery.

By mitigating risk, spreading the cost of new facilities broadly, and enabling new competitors to build transmission, NRECA's approach to new transmission helps to ensure that the interstate highway system can be built at the lowest possible cost to consumers.

Mr. LARGENT. Thank you, Mr. English.

Mr. Gent.

STATEMENT OF MICHEHL R. GENT

Mr. GENT. Thank you, Mr. Largent, and Chairman Barton, and committee members. My name is Michehl Gent, and I am the President and CEO of the North American Electric Reliability Council, often referred to as NAERC.

I am going to restrict my comments to your Title III, which is the provisions for reliability. We do support the reliability provisions of this bill, and we strongly urge this subcommittee to move and approve the language as soon as possible.

The electricity industry is changing in fundamental ways. These changes are disrupting the mechanism that has ensured the reliability of the North American electricity grid.

In order to prevent these changes from jeopardizing the reliability, we must establish a system of mandatory enforceable reliability rules. This bill does just that. As you know the industry is in a great state of flux as regional transmission organizations are forming and reforming, and vertically integrated companies are separating their organizations into different business units.

It is more important than ever that an industry-led self-regulating reliability organization be created to establish and enforce reliability standards applicable to the entire North American grid.

The electric transmission grid is a single interconnective machine that spans the United States and Canadian borders, and having reliability rules developed and enforced by a private organization, in which varied interests from both countries participate, with oversight by the United States by the FERC, and similar review by regulators from Canada, is a practical and effective way to develop a common set of rules needed for the international grid.

FERC plays a critical role in protecting the security, as well as the reliability, of the North American grid, by marshaling the industry's best expertise as to the design and operation of electricity transmission systems in North America.

And by serving as the point of contact for the various government agencies that are interested in national security. Yet, their continuing ability to serve in this function cannot be taken for granted.

This legislation addresses this issue by authorizing FERC to certify a self-regulating electric reliability organization. This new electric reliability oversight system is needed now.

The continued reliability of North America's high voltage electricity grid, and the security of its customers, whose electricity supplies depend on that grid, is at stake.

An industry self-regulatory system is superior to a system of direct government regulation for setting and enforcing compliance with grid reliability rules.

The language of H.R. 3406, with the addition of a State regional advisory body language, presents a sound approach for ensuring the continued reliability of the Northern American electricity grid.

The reliability of North America's interconnective transmission grid need not be compromised by all these changes that are taking place in our industry, provided that we have this legislation and it is enacted now.

I would like to close by commending Chairman Barton for his leadership on these very important electricity issues. Thank you.

[The prepared statement of Michehl R. Gent follows:]

PREPARED STATEMENT OF MICHEHL R. GENT, PRESIDENT AND CHIEF EXECUTIVE OFFICER, NORTH AMERICAN ELECTRIC RELIABILITY COUNCIL

Good morning, Mr. Chairman and members of the Subcommittee. My name is Michehl Gent and I am President and Chief Executive Officer of the North American Electric Reliability Council (NERC).

NERC is a not-for-profit organization formed after the Northeast blackout in 1965 to promote the reliability of the bulk electric systems that serve North America. It works with all segments of the electric industry as well as consumers and regulators to "keep the lights on" by developing and encouraging compliance with rules for the reliable operation of these systems. NERC comprises ten Regional Reliability Councils that account for virtually all the electricity supplied in the United States, Canada, and a portion of Baja California Norte, Mexico.

Summary

NERC supports the reliability provisions (Title III) of H.R. 3406, and strongly urges the Subcommittee to approve this legislation as soon as possible. With or without Congressional guidance, the electricity industry is changing in fundamental ways. These changes are disrupting the mechanisms that ensured the reliability of the North American electricity grid. In order to prevent these changes from jeopardizing the reliability of our electric transmission system, we must adapt how we deal with reliability of the bulk power system. NERC and a substantial majority of other industry participants believe that the best way to do this is through an independent, industry self-regulatory organization with FERC oversight, modeled after the securities industry, where the Securities and Exchange Commission has oversight of several self-regulatory organizations (the stock exchanges and the National Association of Securities Dealers).

Title III of H.R. 3406 embraces this concept, and preserves the key elements of earlier versions of this legislation, such as H.R. 312, introduced earlier this year by Mr. Wynn and co-sponsored by Mr. Shadegg, Ms. Eshoo and Mr. Ehrlich. Aside from a few technical suggestions, the only suggestion for improving the reliability language of H.R. 3406 that NERC would make is to add back the provisions addressing the establishment of State regional advisory bodies and their role in advising reliability entities and the Commission on reliability matters. This language can be found in proposed new Federal Power Act section 215(n) of the Wynn Bill.

Just about two months ago, my colleague, David Cook, testified before the Subcommittee on the subject of reliability legislation. I will not repeat his points, but today will focus on two questions: (1) why is this legislation needed now; and (2) how will Title III of H.R. 3406 meet this need.

Why Is This Legislation Needed Now?

NERC sets the standards by which the grid is operated from moment to moment, as well as the standards for what needs to be taken into account when one plans, designs, and constructs an integrated system that is capable of being operated se-

curely. The NERC standards do not specify how many generators or transmission lines to build, or where to build them. They do indicate what tests the future system must be able to meet to ensure that it is capable of secure operation. NERC's rules, which are not enforceable, have generally been followed, but that is starting to change. As economic and political pressures on electricity suppliers increase and as the vertically integrated companies are being disaggregated, NERC is seeing an increase in the number and severity of rules violations. Moreover, new issues are arising that demand an institution that can act fairly, but decisively, and in a timely manner.

Let me give you an example. Traditionally, integrated utilities operated their generators to supply both the "real" (MW) and "reactive" (MVar) power necessary to maintain secure operation of the transmission system, and charged for these services as part of the regulated cost of service. (It's worth noting here that control of flows on an electric system is not accomplished by valves and switches, as in gas or telecommunications systems, but by controlling the outputs of generators.) These "services" provided by generators included such things as spinning and non-spinning reserves and system voltage support. Now with the generation function separated from the transmission function in many cases, these "services" are no longer provided by a single, integrated entity, but must be arranged and paid for separately through tariffs and contracts with generators. To assure that this is done, we need enforceable standards that require transmission operators (including RTOs) to make adequate provision in their tariffs and contracts for these essential reliability services. How these arrangements are made can be the subject of filings with FERC or other regulators, but they must be made. Absent such enforceable standards, the reliability of our interconnected grids will be at serious risk.

As a result of these changes in the industry, NERC is rewriting all of its reliability standards according to a new "functional" reliability model that sets out measurable and, under Mr. Barton's proposed legislation, enforceable requirements for entities that are responsible for performing critical reliability functions. These new standards will place uniform requirements on those that have the responsibility for maintaining the minute-to-minute balance between load and generation, for seeing that power flows remain within the physical limits of the system, and that grid voltages stay within tolerance.

Let me give you another, very different example of why this legislation is needed. NERC plays a critical role in protecting the security, as well as the reliability, of the North American grid. Since the early 1980s, NERC has been involved with the electromagnetic pulse phenomenon, vulnerability of electric systems to state-sponsored, multi-site sabotage and terrorism, Year 2000 rollover impacts, and most recently the threat of cyber terrorism. At the heart of NERC's efforts has been its ability to marshall the industry's best expertise as to the design and operation of electricity transmission systems in North America, and serve as the point of contact with various federal government agencies including the National Security Council, Department of Energy (DOE), the Nuclear Regulatory Commission (NRC), and the Federal Bureau of Investigation (FBI), to reduce the vulnerability of interconnected electric systems to such threats.

I know that this Subcommittee understands how vitally important this function is. Yet NERC's continuing ability to serve this function cannot be taken for granted. NERC traditionally has been funded by contributions from its Regional Councils. New entrants and the pressure of competitive markets have made this funding mechanism increasingly unsatisfactory. A new funding mechanism is needed that properly and fairly supports NERC's activities, including its activities related to security. H.R. 3406 would address this issue by authorizing FERC to certify an electric reliability organization that, among other things, has established rules that "allocate equitably dues, fees and other charges among end users." See proposed section 215(c)(2)(B)(ii).

Title III of H.R. 3406 Would Provide for an Organization Capable of Protecting the Reliability and the Security of the North American Electricity Grid

We need legislation to change from a system of voluntary transmission system reliability rules to one that has an industry-led organization promulgating and enforcing mandatory rules, backed by FERC in the United States and by the appropriate regulators in Canada and Mexico. Title III of H.R. 3406 would do this. Under these provisions:

- Reliability rules would be mandatory and enforceable.
- Rules would apply to all operators and users of the bulk power system in North America.

- Rules would be fairly developed and fairly applied by an independent, industry self-regulatory organization drawing on the technical expertise of industry stakeholders.
- FERC would oversee that process within the United States.
- This approach would respect the international character of the interconnected North American electric transmission system.
- Regional entities would have a significant role in implementing and enforcing compliance with these reliability standards, with delegated authority to develop appropriate regional reliability standards.

On this latter point, H.R. 3406 authorizes the electric reliability organization approved by FERC to enter into agreements to delegate authority to a regional entity to enforce reliability standards. H.R. 3406, however, omits provisions in previous reliability legislation, such as H.R. 312, that direct the Commission to establish a regional advisory body of State representatives to provide advice to the Commission and the national reliability organization. See proposed new section 215(n) of the Federal Power Act in H.R. 312. NERC would suggest that the State regional advisory body language be added to H.R. 3406.

Having an industry self-regulatory organization develop and enforce reliability rules under government oversight as H.R. 3406 would do, takes advantage of the huge pool of technical expertise that the industry has been able to bring to bear on this subject over the last 30 plus years. Having FERC itself set the reliability standards through its rulemaking proceedings, even if based on advice from outside organizations, would require FERC to develop or acquire technical expertise that it does not now have, and would dramatically expand FERC's workload at perhaps the worst possible time. In addition, reliability rules and market standards need to be worked out together, using a fair and open process, in a collaborative fashion by all segments of the industry. FERC's adjudicative processes are ill-equipped for this.

The electric industry is in a great state of flux, as regional transmission organizations are forming and reforming, and vertically integrated companies are separating and selling off various portions of their business. With all the uncertainty as to who will ultimately operate and plan the interconnected transmission system, it is more important than ever that an industry-led self-regulatory organization be created to establish and enforce reliability standards applicable to the entire North American grid, regardless of who owns or manages it. The self-regulatory reliability organization authorized in H.R. 3406 can help assure that grid reliability is maintained, even while new market structures and new RTOs are being formed. Because FERC will provide oversight of the electric reliability organization in the U.S., FERC can ensure that the organization's actions and FERC's evolving market policies are closely coordinated.

The industry self-regulatory organization authorized in H.R. 3406 also addresses the international character of the interconnected grid. There is strong Canadian participation within NERC now. Having reliability rules developed and enforced by a private organization in which varied interests from both countries participate, with oversight in the United States by FERC and with equivalent activity by provincial regulators in Canada, is a practical and effective way to develop the common set of rules needed for the international grid. Otherwise, U.S. regulators would be dictating the rules that Canadian interests must follow—a prospect that would be unacceptable to Canadian industry and government alike. Or, regulators on either side of the border might decide to set their own rules, which would be a recipe for chaos. There are also efforts under way to interconnect more fully the electric systems in Mexico with those in the United States, primarily to expand electricity trade between the two countries. With that increased trade, the international nature of the North American electricity market will take on even more importance, further underscoring the necessity of having an industry self-regulatory organization, rather than FERC itself, set and enforce compliance with grid reliability standards.

Conclusion

NERC commends the drafters of H.R. 3406 for attending to the critical issue of ensuring the reliability of the interconnected bulk power system as the electric industry undergoes restructuring. A new electric reliability oversight system is needed now. The continued reliability of North America's high-voltage electricity grid, and the security of the consumers whose electricity supplies depend on that grid, is at stake. An industry self-regulatory system is superior to a system of direct government regulation for setting and enforcing compliance with grid reliability rules. The language of H.R. 3406, with the addition of State regional advisory body language, presents a sound approach for ensuring the continued reliability of the North American electricity grid. It is also an approach that has widespread support among industry, state, and consumer interests. The reliability of North America's inter-

connected transmission grid need not be compromised by changes taking place in the industry, provided reliability legislation is enacted now.

Mr. LARGENT. Thank you, Mr. Gent.

Ms. Church.

STATEMENT OF LYNNE H. CHURCH

Ms. CHURCH. Thank you, Mr. Largent, and Chairman Barton, and other members of the committee. I am Lynne Church, President of the Electric Power Supply Association, which is the trade association representing competitive power suppliers.

This includes independent power producers, marketers, and merchant generators. The industry today comprises over 33 percent of the Nation's installed capacity. The draft bill generally endorses a competitive wholesale market, which of course we want, and we deeply appreciate the leadership that Chairman Barton and others on this committee have shown on the issue of electric restructuring.

We support the spirit of this bill, like Chairman Barton absolutely believes in a competitive, reliable, and efficient wholesale market. And many of the provisions of this bill further this goal by providing either needed legislative authority, or affirmation and endorsement of authority that FERC already is implementing.

An example of this provisions include the requirement that all transmitting utilities join regional transmission organizations within 12 months; assurance that currently non-FERC jurisdictional utilities provide open access to their grid; the adoption of predictable, non-discriminatory interconnection standards, which are critical for the investment in construction of new generation; and recognition that there must be authority to enforce reliability standards.

While there is much in the bill to applaud, key provisions in this legislation could hinder the ongoing evolutionary process, and hamper the development of a truly competitive wholesale market.

The new RTO procedures in Section 202 of the bill would slow or even stop the ongoing progress of RTO development, and invite additional litigation and foot dragging. It does this through the requirements for multiple evidentiary hearings, new cost benefit assessments, and court appeals under standards of judicial review that are not currently applicable to the Federal Power Act.

Most critically it provides for a stay of FERC action while these appeals are being heard. These new requirements will provide ample opportunity for obstruction of RTO development by those opposed to truly open access grid.

A second example is the prescriptive approach taken that will prevent progress in fine-tuning the existing ISOs and RTOs that have been approved. It will remove much of the flexibility that FERC and the stakeholders have to adjust and reform these market organizations as the wholesale power market inevitably changes and matures.

A third example is that the definition of market participant is too limited and does not recognize that transmitting organizations compete with generators in alleviating congestion, and that default providers to have generating assets that compete also with competitive assets.

A fourth example is that the reliability provisions do not reflect recent industry developments, and would hinder coordination of reliability standards and market practices.

EPSA endorses the need for mandatory reliability standards that are broadly applicable for the entire industry.

However, this bill does not reflect that FERC must be the ultimate authority to endorse reliability standards, and that RTOs have an important role in enforcing reliability. In addition, the industry has begun a DOE sponsored collaborative standards cross-setting process that would integrate reliability in market practices.

Ideally, this process will produce a new legislative proposal that can be considered by the full committee next spring or next year when it takes up this bill. If I may, I would like to discuss the Enron situation, which has been the underlying current of this whole discussion, and what it does and what it does not mean.

Opponents of the competition have seized upon the occasion of the company's fall to proclaim that electric restructuring should be halted or even reserved. In fact, however, the most persuasive proof of the success of competitive markets was seen in what happened in the markets after the bankruptcy occurred.

As the FERC Commissioner stated yesterday, trading went on without a wrinkle. Competitors immediately stepped into the void and kept prices and supplies on an even kneel. Other trading platforms saw a significant increase in their volume and several new trading platforms are even in the works as we speak.

And most importantly the lights stayed on. While still young, the competitive energy markets have matured to the point where they can withstand the departure of a once-dominant player.

And finally, members of this subcommittee, and to others involved in this debate, a word of caution. Some thought leaders, including financial analysts and commentators, have been making allegations that other competitive suppliers may be quick to follow Enron.

We have already heard some discussion of the Cal-Pine situation that was triggered by some quotes in the New York Times this past weekend. Their stock dropped precipitously, although it is fortunately coming back.

Such irresponsible statements made with no real evidence and a lack of understanding of Cal-Pine's and other suppliers' business models have the potential to repeat the Enron tragedy for other employees and stockholders unjustifiably.

The factor that ultimately brought Enron down was a lack of confidence in their financial strength by investors and customers. I urge caution in debating these issues to avoid casting doubt on other companies' financial strength without knowing the facts.

In closing, thank you for allowing me to testify for the industry today. We look forward to continuing to work with the subcommittee to advance development of a robust competitive market.

[The prepared statement of Lynne H. Church follows:]

PREPARED STATEMENT OF LYNNE H. CHURCH, PRESIDENT, ELECTRIC POWER SUPPLY ASSOCIATION

Chairman Barton, Representative Boucher and members of the Committee, I am Lynne H. Church, President of the Electric Power Supply Association (EPSA) and am here today representing EPSA's member companies. EPSA is the national trade

association representing competitive power suppliers, including independent power producers, merchant generators and power marketers. These suppliers, which account for more than a third of the nation's installed generating capacity, provide reliable and competitively priced electricity from environmentally responsible facilities serving global power markets. EPSA seeks to bring the benefits of competition to all power customers. On behalf of the competitive power industry, I thank you for this opportunity to comment on H.R. 3406, the Electric Supply and Transmission Act.

THE RATIONALE PERSISTS FOR FEDERAL LEGISLATION

We deeply appreciate the leadership that Chairman Barton and others here today have shown on the issue of electricity restructuring and the time and energy this subcommittee has devoted to this topic. We support the spirit of this bill—like Chairman Barton, EPSA believes in a competitive, reliable, efficient, environmentally-friendly wholesale electricity market. Many provisions in this bill further this goal. For example, there is the requirement that all transmitting utilities join regional transmission organizations (RTOs). In addition, the bill will ensure that currently non-FERC-jurisdictional utilities provide open access to the interstate transmission grid.

We particularly endorse the adoption of predictable, non-discriminatory interconnection standards, because we cannot overemphasize how important these rules are for investment and construction of new generation. We have been heavily involved in the regulatory process underway at FERC to resolve these issues. Your bill could give additional impetus to this effort and shortcircuit dilatory litigation.

While there is much in your bill to applaud, key provisions in this legislation could hinder the evolutionary process that started with Energy Policy Act of 1992, and hamper the development of a truly competitive wholesale market. These include language in the sections on RTOs and reliability, which I will discuss in turn.

RTO LANGUAGE WOULD SLOW PROGRESS OF RTO DEVELOPMENT

Although the bill text requires full participation by owners of the interstate transmission grid in RTOs, the provisions in Section 202 of this legislation would stop or dramatically slow progress that is now being made towards RTO development and invite additional litigation and foot-dragging. The provision is prescriptive and includes requirements for multiple evidentiary hearings, a new cost-benefit assessment, court appeals under standards of judicial review not normally applicable to Federal Power Act cases, and—most critically—a stay on FERC action while these appeals are being heard. This new process would radically change the calculations that companies now make when they consider how and whether to take part in the development of an RTO.

The RTO process now underway at FERC is difficult and painful for most participants. But there is no substitute for a deliberative process that allows for the steady evolution of market institutions and needs. We believe that the prescriptive approach laid out in the bill will stop the progress being made towards RTO development while participants take their cases to court. It will also remove much of the flexibility that the FERC has to adjust or reform these market organizations as the wholesale power market inevitably changes in size and scope.

We all agree that RTOs must be independent of any class of market participants in order to be an effective, non-discriminatory manager of the interstate grid. However, the definition of market participant in this bill specifically excludes both transmission owners that do not buy or sell power and entities that own generation but only provide default service. Transmission development clearly affects the market value of generation and default providers have assets that influence regional wholesale prices. The blanket exclusion as it appears in the bill cannot be justified.

Lastly, the language in Title IV, Sec. 216 (a) 6 says that incentive rates should be used to "promote the voluntary participation in and formation" of RTOs. While EPSA does not, in general, object to the use of incentive rates, this particular language should be removed. The language runs contrary to the idea that RTO participation must be mandatory, and conflicts with the RTO section of the legislation.

RELIABILITY PROVISIONS DO NOT REFLECT RECENT INDUSTRY DEVELOPMENTS

With respect to the bill's provisions related to grid reliability, EPSA endorses the need for mandatory reliability standards that are broadly applicable to the wholesale power industry. However, the language in this bill could limit the industry's ability to address the challenges of the ongoing development and restructuring of the wholesale transmission system essential for reliable, efficient and well-functioning markets. As currently drafted, the bill shifts significant aspects of standards

development and enforcement away from FERC to a new electric reliability organization. The text also does little to reflect the role that will need to be played by RTOs in future market management.

Given FERC's substantial responsibility to ensure the reliable and efficient operation of the transmission grid and the imperative to develop effective RTOs, this makes little sense. However, developed energy standards will have an inevitable impact on bulk power transmission systems and market operation essential for reliability. Accordingly, the standard setting process outlined in the bill raises serious concerns that failing to centralize this activity with FERC could lead to confusion and conflicts among multiple entities.

Further, the bill fails to account for recent industry efforts to rethink the nature, scope and organizational structure for a new standards setting process that recognizes the need to integrate reliability and market practices. On December 7th, over 125 representatives from all areas of the industry met at a DOE-sponsored conference co-facilitated by EPSA, EEI, ELCON and NEM. The forum provided an opportunity for all interested parties to begin a broader collaborative effort to consider whether and how to combine NERC's reform proposals with the new North American Energy Standards Board (NAESB) that the Gas Industry Standards Board (GISB) approved on December 5th. As currently written, Chairman Barton's legislation could preempt this important process.

Many participants in the DOE conference acknowledged the potential benefits of merging NERC into NAESB. In a reprisal of the leadership role she assumed as FERC Chair, Betsy Moler challenged all the parties to work on a compromise model for a new standard setting organization. The implications of these developments are clear: legislation should not deny FERC or industry stakeholders the opportunity to develop new approaches to energy standards development. The DOE intends to host another conference on January 28th to discuss the progress on resolving these issues. Ideally, this process will produce a new legislative proposal that can be incorporated in this legislation when it is considered by the full Energy and Commerce Committee next spring.

PURPA OWNERSHIP RESTRICTIONS ARE OUT-OF-DATE

Permit me to make one last point on the legislation: the bill addresses PURPA without repealing the current PURPA ownership restrictions. These restrictions were initially included to encourage non-utility ownership of new power facilities and are now out-of-date. These restrictions are not applicable to other competitive generation, such as exempt wholesale generators, and add unnecessary complexity and inefficiency to the generation industry. While this reform has not yet been included in the Subcommittee bill, this proposal was included in the Senate Democratic energy proposal unveiled recently and in Administration position papers. We urge you to adopt this proposal.

A COMMENT ON THE ENRON BANKRUPTCY

While my testimony today is focused on legislation, it is reasonable to expect the members of the Subcommittee are likely to raise questions related to the recent tragic bankruptcy of an EPSA member company, Enron. Let me make a few comments on the matter.

In the days since the company sought protection under bankruptcy laws, there have probably been hundreds of Enron obituaries published in news and trade papers. Some have been straightforward and thought-provoking examinations of how a company could move so quickly from being an industry innovator to insolvency. Others raised complex and appropriate questions about the diligence of investment analysts or the role of public accounting firms.

However, some of these post-mortem pieces have illuminated little more than the well-established fact that, like every entity that forges a new path to overwhelming success, Enron made some enemies along the way. While it's true and ironic that the competitive markets Enron helped to foster ultimately sealed its fate, they also worked as intended to help shield energy customers from any catastrophic consequences.

Opponents of the competition that Enron helped bring to the nation's energy markets have seized upon the occasion of the company's fall to proclaim that electricity restructuring should be halted or even reversed. In fact, however, the last few months have demonstrated exactly the opposite.

Perhaps the most persuasive proof of competition's power was seen in what happened in energy markets immediately following the largest bankruptcy filing in U.S. history—practically nothing. There's no talk of a bailout, either at the state or fed-

eral level. Trading went on with the many strong competitors who immediately stepped into the void and kept prices and supplies on an even keel.

Although the move toward open markets is still young, competitive energy markets already have matured to the point where they can withstand the departure of a once-dominant player.

Many have used Enron's collapse to predict an end to competitive wholesale power markets. Missing from this chorus of doomsayers, however, are those who watch energy markets most closely. On Wall Street and at the Federal Energy Regulatory Commission, experts understand that Enron's decline, rather than a caution against competitive markets, actually highlights the need to hasten their arrival throughout the nation. These observers remain committed to opening energy markets because they have seen the power of competition put downward pressure on prices, open new reservoirs of supply and encourage efficiency and technology advances at every turn.

In closing, thank you for allowing me to testify here today. We look forward to continuing to work with you to advance the development of a robust, competitive electricity market.

Mr. LARGENT. Thank you, Ms. Church.

Mr. Rouse.

STATEMENT OF JAMES B. ROUSE

Mr. ROUSE. Chairman Barton, Congressman Largent, and members of the subcommittee, I am James Rouse from Praxair, Inc., an industrial gases company in Danbury, Connecticut. I am here as Chairman of and represent the Electricity Consumers Resource Council, or ELCON, the national trade association of large industrial customers.

ELCON recognizes a functioning and competitive wholesale market is necessary to support retail competition, which is slowly being implemented in States throughout the Nation. We continue to believe that retail competition can benefit all consumers if markets are truly open and consumers are free to choose among suppliers who are actually competing.

Unfortunately, too many States, California being prime among them, purport to establish free and open retail markets, but in reality they simply have created the appearance of competition, while operating in more or less the traditional regulatory mode.

The legislation before us today, H.R. 3406, addresses wholesale markets. On behalf of ELCON and its member companies, I compliment Chairman Barton for introducing the bill.

However, while I believe that the legislation represents progress, it has certain shortcomings that would deny wholesale electricity markets from realizing their full competitive potential. Let me take some examples.

The link issue of regional transmission organizations, transmission citing, and the repeal of PUHCA, all of which affect market power. Customer choice in retail access are wonderful goals, but they are worthless if the transmission system does not allow for the free and non-discriminatory movement of electricity from sellers to buyers.

That's why RTOs are important. FERC's actions to date recognize that the scope and configuration of RTOs are essential to their operation. RTOs must be large enough to mitigate market power.

The governance must be truly independent, and not subject to undue influence from vested interests. As I have explained at greater length in my written material, I believe that the language in H.R. 3406 is harmful in that it constrains FERCs ability to objectively analyze a regional market, and ensure that each proposed

regional transmission organization will in fact facilitate the most effective movement of power.

It would encourage smaller—the bill would—smaller rather than larger RTOs, and that is not conducive, in my opinion, to increased competition. Similarly the language in H.R. 3406 could restrict FERC as it continues in its efforts to provide guidance on market design and operation.

This is an issue of vital interest to large industrial users. FERC, under the able chairmanship of Pat Wood, needs the opportunity to be flexible and creative. H.R. 3406 would constrain and inhibit FERC in its current market design docket.

Turning to incentive rates, which Section 401. Let me reiterate what others have said. ELCON has previously stated before this committee that there is no demonstrated reason—other than perhaps greed of monopoly transmission owners——

to provide incentive rate making for construction of new transmission.

This subcommittee in an earlier proceeding heard from somebody from Goldman Sachs, I believe, an analyst who said that investment in transmission is low risk and that traditional rates of return are sufficient to induce investment.

The recently released winter assessment by the North American Electrical Liability Council stated that transmission capacity for this coming winter is adequate. If FERC believes that incentive rates are necessary, which is a decision that can and should be made on a case-by-case basis, they have sufficient authority under the present law.

But I have seen no study or documentation to support this far reaching proposal to implement across the board incentives. Such a provision will produce higher electricity prices for all consumers as previous witnesses have stated, and it may not relieve the transmission congestion where it is truly needed.

ELCON members believe that legislation should address demand-side issues, as well as supply site issues. We view the inclusion of a price responsive demand program in Section 103 as generally positive.

But we question the need to set an arbitrary 5 percent target, which we fear would create yet another Federal program rather than developing a robust customer remote response or CRR market.

There is no magic or correct number for customer load response. Individual consumers should be able to compare the value of continuing to consume electricity to manufacture their products, with a value being paid to reduce the consumption of electricity.

We hope that this section will not result in a traditional Demand-Side Management, responses which have historically resulted only in added costs for consumers, with relatively little reduction in overall demand and virtually no reduction in the system peaks, which is really the most critical area.

We believe that consumers, large and small, if given sufficient information, and appropriate market based incentives, will adjust their electricity consumption accordingly.

No target or any other artificial threshold is necessary or desirable. A final note on reliability. ELCON has worked on this issue

for nearly 5 years. We at ELCON have a simple objective; one organization charged with setting standards for both reliability and commercial practices, and retail and wholesale standards, which we believe those two cannot be separated.

That organization should be overseen by the FERC, and the organization's standard setting practices should be truly fair, open, balanced, and inclusive. The new language proposed in H.R. 3406 may be too prescriptive to achieve that goal.

In conclusion, Mr. Chairman, may I compliment you and your staff for a valuable document. I appreciate the time that you and your staff have spent with industrial users, and in particular, ELCON.

And although we do not believe that this bill in its present form contains all the answers, it does offer a sound structure from which to proceed when the subcommittee begins mark-up.

As always, Mr. Chairman, we thank you for your continuing interest in making electricity markets more competitive.

[The prepared statement of James B. Rouse follows:]

PREPARED STATEMENT OF JAMES ROUSE, CHAIRMAN THE ELECTRICITY CONSUMERS RESOURCE COUNCIL

Mr. Chairman, members of the Subcommittee, I am James Rouse from Praxair, Inc., an industrial gases company headquartered in Danbury, Connecticut. I am Chairman of, and today represent, the Electricity Consumers Resource Council, or ELCON, the national association of large industrial users of electricity. ELCON members represent nearly every segment of the manufacturing community and have operations in every state.

ELCON was established in 1976, and ELCON member companies pride themselves on being among the original proponents of open and competitive retail and wholesale electricity markets. We compete in open markets to sell our products. Since we purchase nearly every other raw material or component needed to manufacture our products in competitive markets. Why shouldn't we be able to purchase electricity in competitive markets as well?

We recognize that a functioning and competitive wholesale market is necessary to support retail competition which is slowly being implemented in states throughout the Nation. We continue to believe that retail competition can benefit all consumers if markets are truly open and consumers are free to choose among suppliers who are actually competing. Unfortunately too many states (California being prime among them) purport to establish free and open retail markets but in reality have simply created the appearance of competition, while operating in the traditional regulatory mode.

The legislation before us today, HR 3406, addresses wholesale markets. On behalf of ELCON and its member companies, I compliment Chairman Barton for introducing this bill. While I believe that the legislation represents progress, it has certain shortcomings that would deny wholesale electricity markets from realizing their full competitive potential.

Take, for example, the linked issues of regional transmission organizations (RTOs), transmission siting, and the repeal of the Public Utility Holding Company Act (PUHCA), all of which affect market power. Customer choice and retail access are wonderful goals, but they are worthless if the transmission system (which will remain monopolistic for many years) does not allow for the free and non-discriminatory movement of electricity from seller to buyer. Given that owners of monopoly transmission facilities will still possess and exercise market power—that is monopoly power—I cannot emphasize too strongly that some regulation is needed to ensure that the owners of transmission systems do not use their government-granted monopoly power to the detriment of real competition and consumers.

That is why RTOs are so important. FERC's actions to date recognize that the scope and configuration of RTOs are essential to their operation. RTOs must be large enough to mitigate market power. Their governance must be truly independent and not subject to undue influence from vested interests. I believe that the language in HR 3406 is harmful in that it constrains FERC's ability to objectively analyze a regional market and ensure that each proposed regional transmission or-

ganization will, in fact, facilitate the most efficient movement of power and increase competition in wholesale markets.

The two tests proposed in this bill as a means of demonstrating adequate scope and configuration of an RTO are both flawed. Asking an RTO to conduct a cost-benefit study is an invitation to litigation—litigation that will be based only on dueling—and probably inconclusive—cost-benefit analyses. This will not resolve the issue quickly, nor will it necessarily resolve the issue properly. The "generation sufficiency" test is based on a faulty premise; it would encourage smaller rather than larger RTOs and, furthermore, it is simply not workable for several reasons. Sufficient generation within an RTO is an irrelevant factor. In an optimally constructed wholesale market, we would have large seamless RTOs where power can flow not only within but between RTOs so that the most efficiently produced electricity can reach the greatest number of consumers. A generation sufficiency test invites monopoly transmission owners to exclude from an RTO new, more efficient generation facilities once the generation sufficiency test is met. It also fails to consider both load increases and generation changes that could transform generation sufficiency to generation insufficiency. I could go on, but we see no reason to hamstring or otherwise restrict FERC as it looks at proposed RTOs under the guidelines it promulgated in Order 2000.

Similarly, the language in HR 3406 could restrict FERC as it continues its efforts to provide guidance on market design and operation. This is an issue of vital interest to large industrial users. In fact, six ELCON members, including my own company, recently submitted affidavits to FERC as part of an ELCON filing in FERC's docket on market design, pointing out that the model now utilized by the PJM-ISO, while favorable in many ways, should not necessarily be used as the sole template for "best practices" throughout the Northeast and the Nation. At a minimum, the existing flaws in PJM should be fixed before its platform is extended to the entire Northeast region. FERC, under the able Chairmanship of Pat Wood, needs the opportunity to be flexible and creative. HR 3406 would constrain and inhibit FERC in its current market design docket.

Turning to incentive rates (Section 401), let me reiterate what ELCON has previously stated before this Subcommittee. There is no demonstrated reason—other than the greed of monopoly transmission owners—to provide incentive rate-making for the construction of new transmission. The Subcommittee, in an earlier proceeding, heard from a Goldman Sachs analyst that investment in transmission is low risk and that traditional rates of return are sufficient. The recently released Winter Assessment by the North American Electric Reliability Council (NERC) stated that transmission capacity for this coming winter is adequate. There may be specific areas where new transmission is necessary to alleviate congestion. Path 15 is an obvious example. But simply giving the monopoly transmission owners a higher return on transmission will not motivate them enough to relieve congestion that is now protecting their high-cost generation. If FERC believes incentive rates are necessary—a decision that can and should be made on a case-by-case basis—they have sufficient authority under present law. But I have seen no study or documentation to support this far-reaching proposal to implement across-the-board "incentives." Such a provision will produce higher electricity prices for all consumers and may not relieve transmission congestion where it is truly needed.

Rather than simply requiring incentive rates, first remove governmental impediments. One way to remove impediments is to offer a federal right of eminent domain for the siting of transmission lines. There is no reason that the siting of new transmission lines should be treated differently from the siting of new natural gas pipelines. The language in HR 3406, by a providing federal backstop, is a good, though incomplete, first step.

Turning to PUHCA repeal, this statute is the only federal consumer protection statute for electricity consumers. No *bona fide* consumer group supports the repeal of PUHCA without adequate replacement provisions. We believe that there should be clear authority vested in the FERC to prohibit any potential anti-competitive practices involving regulated utilities and unregulated affiliates. Rules are needed to address the operational unbundling of generation, transmission, system control, marketing and local distribution functions. State and Federal regulators must have complete access to all books and records of all regulated entities and entities owned or controlled by regulated entities. In addition, PUHCA repeal should not be effective until states have retail access or until competition on a nation-wide basis is otherwise achieved. ELCON and ELCON members find the language in HR 3406 lacking in this regard.

ELCON witnesses and others have long defended before this Subcommittee the Public Utility Regulatory Policies Act (PURPA), including the need for back-up power in non-competitive states (which we are pleased is included in this bill. I will

make the case—very briefly—from a slightly different perspective. Utilities claim PURPA has resulted in higher rates for consumers. By definition, this cannot happen as long as PURPA is implemented correctly. In fact industrial users value PURPA as having brought competition to the electricity marketplace. Any higher prices, if there were any, were the result of state-approved actions and of poor decision-making by utilities. To repeat a point ELCON witnesses have made previously: PURPA did not create above market contracts for utilities. In fact utilities have more above-market contracts with other utilities than they do with PURPA qualifying facilities. It is worth noting that only utilities, not consumers, are seeking the repeal of PURPA's purchase and sale provisions.

ELCON members believe that legislation should address demand side issues as well as supply side issues. We view the inclusion of a "Price-Responsive Demand Program" in Section 103 as generally positive. But we question the need to set a "5 percent" target, which we fear would create yet another federal program rather than developing a robust customer load response (CLR) market. There is no magic or "correct" number for CLR. Individual consumers should be able to compare the value of continuing to consume electricity to manufacture their products with the value of being paid to reduce their consumption of electricity. We hope that this Section will not result in traditional Demand Side Management responses, which have historically resulted only in added costs for consumers and relatively little reduction in overall demand and virtually no reduction in system peaks. We believe that consumers—large and small—if given sufficient information and appropriate market-based incentives will adjust their electricity consumption accordingly. No target or any other artificial threshold is necessary or desirable.

A final note on reliability. For nearly five years ELCON has worked with NERC to craft language creating a new reliability organization that recognizes both changes in the transmission system and changes in the electricity stakeholder community. We lately have worked with the Gas Industry Standards Board (soon to be renamed the North American Energy Standards Board) as they too attempt to provide structure and guidance to our interstate electricity grid. We at ELCON have a simple objective: one organization charged with setting standards for both reliability and commercial practices and retail and wholesale standards (because we believe that they cannot be separated). That organization should be overseen by FERC. The organization's standard-setting practices should be truly fair, open, balanced and inclusive. The new language proposed in HR 3406 may be too prescriptive to achieve that goal.

In conclusion, Mr. Chairman may I compliment you and your staff for a valuable document. I appreciate the time that you and your staff have spent with industrial users. Although we do not believe that this bill, in its present form, contains all of the answers, it offers a sound structure from which to proceed when the Subcommittee begins markup. May I observe that the State of Texas has conferred on our Nation its President, the chairman of the FERC, and the chairman of this Subcommittee. Seldom is a single state the source of such potential for the improvement of our country's electricity market. And, as always, Mr. Chairman, we thank you for your continuing interest in making electricity markets more competitive.

Mr. LARGENT. Thank you, Mr. Rouse.

Mr. Acquard.

STATEMENT OF CHARLES ACQUARD

Mr. ACQUARD. Thank you, Mr. Chairman and members of the subcommittee. I am Charlie Acquard, Executive Director of the National Association of State Utility Consumer Advocates. I am here today testifying on behalf of Consumers for Fair Competition.

Our ad hoc coalition believes that Congress and the Federal Energy Regulatory Commission must take clear and significant steps to promote the market structure needed to foster and sustain effective competition in wholesale electric markets, and its associated consumer benefits.

The events of the past year in California highlight the imperfections in the market, and the consumer consequences of failing to promote effective competition. CFC is pleased that the FERC has begun to take the steps to address these problems.

Any electricity legislation approved by Congress should affirm and strengthen the general direction taken by FERC. Anything else will undermine the creation of effectively competitive wholesale markets and harm the interests of consumers.

Regrettably, H.R. 3406 fails to do this. Rather, it retreats from current law and reasons for policy initiatives, and actually reduces consumer protections. Specifically, CFC believes that the following changes to this proposal are necessary to promote effective wholesale competition.

First, H.R. 3406 will repeal the Public Utility Holding Company Act. We continue to oppose PUHCA repeal unless a company by provisions that satisfy the underlying purpose of the Act; consumer protection, mitigation and market power; prevention of abusive affiliate transactions; and effective regulatory oversight.

H.R. 3406 does not include these basic consumer protections. Therefore, CFC urges the subcommittee to permit PUHCA repeal only if other changes outlined below are simultaneously adopted, or other steps are taken to ensure competitive wholesale markets and non-abusive utility affiliate transactions.

Second, CFC again urges the subcommittee to strengthen the utility merger review and "FERCs merger review authority." We believe mergers should be approved only if they promote the public interest, resulting in discernible consumer and competitive benefits.

Rather than ensure effective scrutiny of all proposed utility mergers, H.R. 3406 retreats from current law. Therefore, CFC urges the subcommittee to delete Sections 141 and 142 of H.R. 3406, and instead amend Section 203 of the Federal Power Act to, one, require utility mergers to promote the public interest to be approved.

And, two, ensure that FERC has clear authority to review mergers between holding companies, convergence mergers between gas and electric utilities, and generation only asset sales.

Third, the CFC commends you, Mr. Chairman, for addressing the thorny issue of RTO formation and attempting to forge a compromise. However, we do not believe that the language contained in H.R. 3406 will permit the grid management needed to support effective wholesale competition.

Therefore, CFC urges this subcommittee to replace Section 202 with language affirming the authority of the Commission to promote RTOs and produce clear and discernible consumer benefits.

Fourth, we continue to strongly oppose mandated incentive or performance based rates for transmission as contained in Section 401. The Federal Power Act currently provides sufficient latitude for adopting of incentive and performance based transmission rates, provided that such rates be statutory and mandated, and a just and reasonable determination.

Section 401 would effectively redefine the just and reasonable standard and require incentive rates for transmission service. We similarly would oppose then the inclusion of negotiated rates that would violate the tenants of the Federal Power Act.

Therefore, CFC urges the deletion of Section 401. Fifth, CFC supports the increase in criminal and civil penalties for Federal Power Act violations that is contained in H.R. 3406.

However, this action does not provide the guidance and tools needed to establish competitive markets, oversight of those markets, and remedies for market flaws, manipulation, and abuse.

CFC cannot support electricity legislation that fails to include effective market power provisions. CFC urges the subcommittee to include provisions to, one, require the establishment of clear rules defining the conditions necessary for competitive markets and market-based rate authority.

Two, establish information disclosure requirements and a market monitoring responsibility. Three, direct FERC to take any action necessary to penalize violations of market rules, correct market flaws, and imperfections, and remedy and mitigate market manipulations and market power abuses.

And, four, remove the time restrictions on rate refunds contained in existing law. Finally, any treatment of market power must also address the potential for abuse in the area of affiliate transactions. Such abuses bring with them intended harm to rate payers and competition alike.

Neither FERC nor the individual State Commissions currently possess the jurisdiction authority to oversee the relationship between utilities and their affiliates that engage in unregulated, multi-State, non-poor, business operations.

With proper oversight these affiliate transactions can lead to unfair competition, and higher rates from captive customers. Therefore, CFC urges inclusion of effective mechanisms to prevent abuse of any competitive affiliate transactions.

We propose extending Federal Trade Commission Authority and unfair competition, and trade practices, in the energy services market. In conclusion, competitive wholesale electric markets can produce consumer benefits.

However, those benefits will not materialize or be consistently available if the market is not structured to ensure its competitive functioning. FERC has taken steps since the extension of Chairman Wood to take the necessary steps.

However, the direction of the Commission can radically shift through changed membership, judicial challenge, and political pressure. We believe that the market and consumers will benefit from statutory support for the general policy direction of the current Commission, providing clear statutory guidelines and tools consistent with the policies outlined in our testimony, will foster a robust and competitive market, and provide certainly to market participants, avoid unnecessary delay, and ensure that consumers benefit.

Thank you, Mr. Chairman, for this opportunity, and I would be happy to answer any questions that the subcommittee might have.

[The prepared statement of Charles Acquard follows:]

PREPARED STATEMENT OF CHARLIE ACQUARD ON BEHALF OF CONSUMERS FOR FAIR COMPETITION

Mr. Chairman, members of the Subcommittee, I am Charlie Acquard, Executive Director of the National Association of State Utility Consumer Advocates. I am testifying today on behalf of the Consumers for Fair Competition (CFC), an ad hoc coalition of consumer-owned utilities, small and large electric consumer representatives, small business interests, and others. While the interests of these organizations are diverse, we are unified in the belief that Congress and the Federal Energy Regulatory Commission (FERC) must take clear and significant steps to promote the

market structure needed to foster and sustain effective competition in wholesale electric markets, and its associated consumer benefits.

The events of the past year in California highlight the imperfections in the market and the consumer consequences of failing to promote effective competition. CFC is pleased that the Federal Energy Regulatory Commission (FERC) has begun to take steps to address these problems, including actions to advance RTOs, refine the screen for market-based rates and lay out conditions for approval of performance-based transmission rates. Any electricity legislation approved by Congress should affirm and strengthen the general direction taken on these issues by FERC. Anything else will undermine the creation of effectively competitive wholesale markets and harm the interests of consumers.

Specifically, CFC's urges the subcommittee to include the following provisions in electricity legislation:

- The development and application of effective market rules, oversight and enforcement for wholesale electric markets that parallels those that exist for the securities industry;
- A stronger standard for approval of proposed utility mergers—and application of that standard to all mergers, combinations and asset sales;
- Formation of large, independent regional transmission organizations that possess strong maintenance, planning and expansion responsibility;
- Limitations on utility diversification and inter-affiliate transactions to protect consumers, promote fair competition, and prevent complicated transactions that pose risks to investors; and
- Provides necessary consumer protections as part of any PUHCA repeal effort.

Regrettably, as outlined below, H.R. 3406 fails to advance these necessary policies, retreats from current law and recent FERC policy initiatives, and reduces consumer protections. CFC offers you the following detailed comments and looks forward to working with the subcommittee in making those changes necessary to ensure effective wholesale competition.

PUHCA Repeal

Title I—Subtitle B of H.R. 3406 would repeal the Public Utility Holding Company Act of 1935 (PUHCA). As CFC has previously testified before this subcommittee, we oppose PUHCA repeal unless accompanied by provisions that satisfy the underlying purposes of the Act—consumer protection, mitigation of market power, prevention of abusive affiliate transactions and effective regulatory oversight. H.R. 3406 does not include these basic consumer protections.

CFC urges the Subcommittee to permit PUHCA repeal only if the other changes outlined below are simultaneously adopted, or other steps are taken to ensure competitive wholesale markets and non-abusive utility affiliate transactions.

Merger Review

As detailed in prior testimony, CFC urges the Subcommittee to strengthen utility merger review and close gaps in FERC's merger review authority. We believe mergers should be approved only if they promote the public interest—resulting in discernable consumer and competitive benefits. The rapid rate of industry consolidation threatens to reduce competition, frustrate market entry and create new opportunities for market power abuse by far-flung economic empires. In addition, CFC agrees with FERC Chairman Pat Wood and the Administration that FERC merger review should extend to holding company mergers and generation-only asset sales. We also believe that the proposed Dynegy acquisition of Enron underscores the need for FERC review of "convergence" mergers between electric and gas utilities.

Rather than ensure effective scrutiny of all proposed utility mergers, H.R. 3406 retreats from current law. Title I—Subtitle D would eliminate important merger review and conditioning authority by the FERC and Nuclear Regulatory Commission (NRC). Repealing Section 203 of the Federal Power Act—combined with repeal of the Security and Exchange Commission's merger review under PUHCA—drastically reduces effective merger review and eliminates the ability of FERC to condition proposed mergers on those actions necessary to protect the public interest and facilitate effective competition. The Justice Department and Federal Trade Commission lack the resources and expertise to effectively review proposed mergers and the on-going regulatory responsibility to enforce merger conditions.

CFC also opposes Section 142 that would eliminate prospective NRC anti-trust review and allow for the waiver of existing anti-trust license conditions. Contrary to the section's title, this review is not "duplicative", since it is not performed by any other anti-trust agency at the time of license issuance or renewal. NRC anti-trust review has been an effective tool in securing transmission access over the years—and the transmission agreements resulting from these reviews form much of the

basis for the competition that exists in the wholesale electric market today. Rather than upholding these existing transmission rights, Sec. 142 of H.R. 3406 would allow these transmission rights to be waived, thereby undermining efforts to promote fair and equal transmission access.

CFC urges the Subcommittee to delete Sec. 141 and 142 and, instead, amend Sec. 203 of the Federal Power Act to (1) require utility mergers to promote the public interest to be approved, and (2) ensure that FERC has clear authority to review mergers between holding companies, convergence mergers between gas and electric utilities, and generation-only asset sales.

RTO Formation

CFC commends you, Mr. Chairman, for addressing the thorny issue of RTO formation and attempting to forge a "compromise." However, we do not believe that the language contained in H.R. 3406 will promote the grid management needed to support effective wholesale competition. We believe that Section 202, while attempting to require full RTO participation, suffers from the following shortcomings:

- An unusual judicial review system is established, with the FERC RTO directive stayed while the proposal undergoes seemingly endless rounds of review and appeal.
- The provision is extremely prescriptive and limiting. The California experience has showed us that the competitive wholesale market is still in its infancy. Unfortunately, Section 202 limits the ability of FERC to respond to the markets growing pains by preventing the Commission from modifying the scope, configuration, governance structure or other key elements of existing RTOs. In addition, it cannot use its other authorities under the Federal Power Act to require RTO participation or RTO modification. This legal straightjacket will impede the natural evolution of RTOs and the market.
- The "scope and configuration" standard appears to provide for self-certification by the applicant that the RTO is "good enough"—even if it would otherwise fail FERC's standard.
- A "market monitoring" standard that lacks effective enforcement authority. While the independent market monitoring unit would gather information and monitor tariff compliance, any noncompliance or structural flaws uncovered by these units are left to the market participants to address.

CFC urges the Subcommittee to replace Sec. 202 with language affirming the authority of the Commission to promote RTOs that produce clear and discernable consumer benefits.

Incentive Rates for Transmission

As CFC testified at the Subcommittee's October 10 hearing, we oppose mandated incentive or performance-based rates for transmission as contained in Sec. 401 of H.R. 3406. The Federal Power Act currently provides sufficient latitude for adoption of incentive and performance based transmission rates—provided that such rates meet the statutorily mandated "just and reasonable" determination. Section 401 would effectively redefine the "just and reasonable" standard and require incentive rates for transmission service. We similarly would oppose the inclusion of "negotiated rates" that would violate the tenets of the Federal Power Act.

In an October 25 order, FERC highlighted the problems inherent in a blanket incentive rate directive. In that case, the applicant sought performance-based rates for renovation of a high-voltage line. In rejecting the application, FERC determined that the proposal did not balance risks and rewards, lacked an effective baseline against which to measure performance, and created a perverse incentive to allow the degradation of transmission facilities in order to then reap the later incentive for renovation work.

CFC urges the deletion of Section 401. If the issue of incentive or performance-based rates must be addressed, then CFC would urge the adoption of either (1) a directed rulemaking for FERC to determine what actions are needed, consistent with Sec. 205 and 206 of the Federal Power Act, to promote the efficient expansion and improvement of interstate transmission networks, or (2) a performance-based rate standard that mirrors the recent FERC case and determine when such rates would produce demonstrable beneficial behavior, investment or actions that are unlikely to occur absent such rates.

FERC Authority on Anti-Competitive Conduct

CFC supports the increase in criminal and civil penalties for Federal Power Act violations that is contained in Title VII of H.R. 3406. However, this action does not provide the guidance and tools needed to establish competitive markets, oversight of those markets, and remedies for market flaws, manipulation and abuse. CFC can-

not support electricity legislation that fails to include effective market power provisions.

CFC urges the Subcommittee to include provisions to:

- *Require the establishment of clear rules defining the conditions necessary for competitive markets and market-based rate authority;*
- *Establish information disclosure requirements and a market monitoring responsibility;*
- *Direct FERC to take any action necessary to penalize violations of market rules, correct market flaws and imperfections and remedy and mitigate market manipulations and market power abuses; and*
- *Remove the time restrictions on rate refunds contained in existing law.*

Affiliate Transactions

Any treatment of market power must also address the potential for abuse in the area of affiliate transactions. The repeal of PUHCA, the growth of unregulated business ventures owned and controlled by utilities and their parent companies, and the increasingly interstate nature of affiliate operations have all fostered additional opportunities for anti-competitive self-dealing, cross-subsidization and cost-shifting. Such abuses bring with them attendant harm to ratepayers and competition alike. Neither FERC nor the individual state commissions currently possess the jurisdiction and authority to oversee the relationship between utilities and their affiliates that engage in unregulated, multistate, non-core business operations. Without proper oversight, these affiliate transactions can lead to unfair competition and higher rates for captive consumers.

CFC urges inclusion of effective mechanisms to prevent abusive and anti-competitive affiliate transactions. We propose extending Federal Trade Commission authority to prevent unfair competition and trade practices in energy services markets.

Conclusion

Competitive wholesale electric consumers can produce consumer benefits. However, those benefits will not materialize, or be consistently available, if the market is not structured to ensure its competitive functioning. FERC has taken steps, since the ascension of Chairman Wood, to take the necessary steps. However, the direction of the Commission can radically shift—through changed membership, judicial challenge and political pressure. We believe that the market—and consumers—will benefit from statutory support for the general policy direction of the current Commission. Providing clear statutory guidance and tools, consistent with the policies outlined in our testimony, will foster a robust, competitive market, provide certainty to market participants, avoid unnecessarily delay, and ensure that consumers benefit.

Consumers for Fair Competition looks forward to working with you to make the changes necessary to accomplish these objectives.

Mr. LARGENT. Thank you, Mr. Acquard.

STATEMENT OF WILLIAM R. PRINDLE

Mr. PRINDLE. Thank you, Mr. Largent, Mr. Chairman, and members of the committee, my name is Bill Prindle, and I am the Director of Buildings and Utilities Programs for The Alliance to Save Energy.

The Alliance is a bipartisan, non-profit, coalition of business, government, environmental, and consumer leaders, dedicated to improving the efficiency with which our economy uses energy.

I would like to talk to you today about energy efficiency, and demand resources, and demand response, and that is part of the wider world of what we called distributed resources, which includes renewables and distributed generation in their many forms.

Now, we have known for a long time that efficiency in the other distributed resources can often be the fastest, cleanest, cheapest way to meet a large part of our energy needs.

And I would also just like to point out that since September 11th that we have been forced to also consider the fact that we need to

really need to focus more intently on the security of our energy systems.

So in that light I would add a fourth superlative and say that efficiency in distributed resources are also the safest way to secure our energy systems.

Overall, I would like to say that H.R. 3406, while it commendably touches on demand response in Section 103, overall we feel that it misses a golden opportunity, an opportunity to use distributed resources and energy efficiency to make electric markets safer, more efficient, to reduce customer bills, to reduce the risk of blackouts, and to improve air quality.

I would like to highlight some of the issues and tell you four things that we would like to see in the bill. First, let's take a look at the real world and what is going on out there. Now, we see a few good things happening out in the marketplace, but we don't see that matched in the way that Federal policy is going.

Now, we have seen that deficiency in distributed resources can help reduce the risk of blackouts, and can help drive down marginal prices in wholesale markets, especially at those key peak times, and can improve air quality.

In the State of New York, Governor Patacki has instituted programs that among other things replaced 40,000 air-conditioners last summer, which took several megawatts off the peak.

They also worked with the ISO to encourage pilot programs and demand response, taking several hundred megawatts again off the peak there. The State of Texas has been an innovator in using energy efficiency for air quality compliance.

There is a new State energy code in Texas that is there largely because there is a need to reduce NOX emissions; and even in the State of California, regardless of who you would choose to blame with all the problems that have occurred in California, we now have some data on how California is working its way out.

In the last year, we know for instance that while about 2,400 megawatts of new supply have come on-line, we have also seen documentation from the energy commission that 6,600 megawatts of demand-side resources have come into play in California.

So that is a more than 2-to-1 margin and clearly distributed resources are delivering big time when it counts. So, now let's turn to the Federal policy world. Earlier this year the FTC issued a report on electricity competition, and they had a chapter on demand-side resources, and the sub-title of the chapter was, "The Sound of One Hand Clapping."

And I think that phrase kind of sums up the situation that we have in our electricity markets, where it is all sellers and no buyers. I mean, clearly, we wouldn't want to run a stockmarket that only put options and no call options.

E-Bay could not survive if only sellers and no buyers were allowed to log on to the system. This is the kind of fundamental problem that we are facing in our electricity markets today.

There are built-in market barriers that discourage generators and distribution companies from doing anything to reduce sales. In fact, their profits only go up as sales go up.

So the question arises, well, what is the Federal role in this, and why can't the States just take care of this on their own as some

of them have been attempting to do. I think the bottom line is that we are trying to move toward regional and national markets for electricity.

And in order to do that, we have to have some consistency in market rules, and we have to have a level playing field as far as how distributed resources are treated in these increasingly regional markets.

And I would just ask that people in Oregon who have seen their prices go up on an average of 30 percent in the last year because of what happened in California, whether they think that energy efficiency and electricity matters are a State issue only.

So, let me just give you four things that we would like the committee to look at in the course of marking up this legislation. The first is what we call a public benefits fund.

A lot of States have tried this, and more than 20 States are now using this kind of a tool. Essentially, it establishes a very small charge on electricity sales of typically one mil.

And what this would do is essentially replace the billion or more dollars that has been lost in the last 5 or 6 years as States and utilities have cut back their efficiency programs looking toward competition.

Nobody knew what was going to happen, and a lot of States and a lot of companies drop their programs, and this would help to replace that resource commitment. The second issue that we want the committee to look at is an energy efficiency performance standard, and this was really pioneered in the State of Texas.

Governor Bush signed a restructuring bill that essentially required utilities to offset 10 percent of their projected load growth with energy efficiency. I met with people from AEP and Reliant, and TXU last week, and they are all cranked up and they are going to spent $75 million next year on programs to implement that.

This approach would simply apply this in a modest way across the Nation, and would establish a 1-percent target, or electricity retailers to reduce sales, a lot of flexibility and the means to do that. And even the ability to trade among companies if one company is not able to meet its target in a particular year.

Most pertinent to Section 103, we have several recommendations for how to make demand response truly functional in the wholesale market, and I won't go into all those details.

But our written statement contains three categories of items that we think are important to include in making demand response markets work properly, and truly enabling customers to participate fully.

And finally, Mr. Chairman, and members of the committee, I would like to emphasize the importance of metering in all of this. The meter is either the gateway or the barrier for customers to participate effectively in these markets.

And we have a fundamental problem here in that smart metering is not in place for most customers. It is for some larger customers, but most customers are not able to use this technology.

So we need two things. We need uniform protocol for how metering is designed and installed so that there can be a national market; and second of all, we need a customer right-to-choose that allows a customer to get a smart meter installed if they want one.

And no distribution company rule or other red tape should prevent a customer from getting that kind of choice, just as customers should have the right to choose their power supplier.

With that, I will stop. Thank you for the opportunity to speak, and I will be happy to answer any questions at this time.

[The prepared statement of William R. Prindle follows:]

PREPARED STATEMENT OF WILLIAM R. PRINDLE, DIRECTOR, BUILDINGS AND UTILITIES PROGRAMS, THE ALLIANCE TO SAVE ENERGY

Mr. Chairman and members of the Committee, thank you for the opportunity to speak with you today on energy efficiency and demand response as vital components of electricity policy. Efficiency and demand response are the cleanest, cheapest, and fastest ways to match electricity demand with supply, reduce price volatility, cut electric bills for American families, prevent power outages, and improve air quality.

My name is William R. Prindle. I am Director of Buildings and Utilities Programs for the Alliance to Save Energy, a bi-partisan, non-profit coalition of business, government, environmental, and consumer leaders dedicated to improving the efficiency with which our economy uses energy. Senators Charles Percy and Hubert Humphrey founded the Alliance in 1977; our Chairman today is Senator Byron Dorgan, and our vice chairs are Senator Bingaman, Senator Jeffords and Congressman Ed Markey.

Over seventy companies and organizations currently belong to the Alliance to Save Energy. If it pleases the Chairman I would like to include for the record a complete list of the Alliance's Board of Directors and Associate members, which includes many of the nation's leading energy efficiency firms, electric and gas utilities, and other companies providing cost savings and pollution reduction to the marketplace.

The Alliance has a long history of researching and advocating energy efficiency policies and programs. We also have a long history of supporting energy efficiency promotion efforts that rely not on mandatory federal regulations, but on partnerships between government and business, and between the federal and State governments. Federal energy efficiency programs at the Department of Energy (DOE), the Environmental Protection Agency (EPA), and other agencies are largely voluntary programs that further the national goals of environmental protection, as well as broad-based economic growth, national security and economic competitiveness.

Electricity Restructuring So Far: The Sound of One Hand Clapping

Mr. Chairman, as we observe the record of electricity restructuring in this country, we see a mixed picture. While some parts of some markets have been restructured with varying degrees of success, overall there is a striking imbalance between policies aimed at the supply side of the industry and those intended to employ the resources available on the demand side, the customer side of the meter. The Federal Trade Commission, in its report on restructuring earlier this year, aptly subtitled the chapter on demand-side resources "The Sound of One Hand Clapping"", referring to the almost total lack of focus on demand-side resources in today's markets.

Clearly, we need to do more to make electricity markets truly competitive. Electricity policy without the proper balance between supply and demand is like a stock market with all put options and no call options. Buyers and sellers need to be able to participate fully in a real competitive market, and right now that is not the case in our electricity markets. Customers are still mostly forced to take prices determined by sellers, and are not able to realize the full market value of the resource they can offer from their own operations. We need strong and clear policies that enable energy efficiency and demand response to make the contributions they are capable of making.

Stronger policies for efficiency and other distributed resources are needed in our electricity policy because in competitive electricity markets operating in the U.S. today, there are built-in barriers to the development of these resources. For example: in a competitive generation market, generators have no financial incentive to promote either efficiency or load management, and their profits increase with increases in sales and in peak demand. Additionally, under the rate designs used in most states, wires companies profit from increased throughput, and find their profits harmed by energy efficiency programs. Because of these structural barriers, neither providers, nor load-serving entities, nor end-users see the real value that demand-side resources can provide to the market and the grid. These market barriers make U.S. wholesale electric markets more expensive, more volatile, and less reliable than they should be.

In addition to making markets fairer and more efficient, efficiency and demand response can help solve the pressing problems facing our electricity systems, such as:

- **Increased price volatility.** Electric demand has grown faster than was projected in the early days of restructuring. The Federal Energy Regulatory Commission's 1995 projection of national electric demand through 2000 was lower than actual experience by 4.6 percent [1]. In the western, Northeast, and Midwest markets we have seen unprecedented peak price problems. This stems from several factors, but a key is the needless "peakiness" of demand. These situations have dramatically illustrated the need to manage demand along with supply. Effective demand response programs can reduce prices through an entire power pool, benefiting all customers.
- **Worsened system reliability.** These peak problems have led to blackouts, brownouts, emergency voltage reductions, and other extraordinary actions by power pool managers from California to Chicago and New York. While it is important to boost the reliability of the grid infrastructure, it is typically faster and cheaper to reduce the overall load on the system first. For this reason the National Association of Regulatory Utility Commissioners has adopted a resolution urging Congress to include in energy legislation "workable mechanisms to support cost-effective State, utility, and market participant energy efficiency programs in order to enhance the reliability of the nation's electric system." [2]
- **Increased air pollution.** These demand increases have increased interstate air pollution, especially nitrogen oxides (NO_X), which contribute to smog and acid rain. The 1995 FERC projection of nitrogen oxide emissions turned out to be 4.3 percent lower than actual emissions in 2000 [3]. Saving energy, especially at peak times, has an especially strong effect on reducing such air pollution.

Comments on H.R. 3406

We appreciate the fact that the Chairman has included a section in the bill on demand response in Title 1, Subtitle A, Section 103, in recognition of the fact that electricity markets should be truly competitive by addressing demand-side resources. While we support the general principles expressed in Section 103, we are disappointed in the bill's broader failure to address energy efficiency and other distributed resources, such as renewable energy. We want to emphasize that energy efficiency and demand response, while often compatible, are different and require different kinds of policy support. Energy efficiency can provide peak demand benefits, and demand response, which is aimed primarily at load management, can also save energy. It thus essential to address both efficiency and demand response explicitly in H.R. 3406.

We believe that more substantial and specific measures are needed to create a better balance between supply-side and demand-side resources. We also suggest the Committee take advantage of the "research" done by the states in testing various electricity policy options. The states have experimented with a variety of efficiency, distributed-resource and renewable policy options in restructuring their electricity markets. These have included public benefits funds, efficiency performance standards, and renewable portfolio standards. We support all of these as part of a balanced electricity policy, and commend them to the Committee as worthy of its consideration.

In the context of energy efficiency and demand response in H.R. 3406, we respectfully ask the Committee to consider additional provisions for the policies described below.

A Public Benefits Fund. We need a federal public benefits fund to reverse the decline in public benefits spending over the last several years. Over the last two decades, states were able to use Integrated Resource Planning to generate a network of utility demand-side management programs that succeeded in avoiding the need for about 100 300-Megawatt powerplants [4]. However, utility spending on these programs has been cut by half as the electricity industry has been deregulated. To offset the lost benefits in reducing peak demand, cutting customer bills, helping low-income people, and supporting the development of new technology, the Alliance sup-

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[1] North American Commission for Environmental Cooperation, *A Retrospective Review of FERC's Environmental Impact Statement on Open Transmission Access,* 19 October 2001

[2] Resolution Supporting Energy Efficiency and Load Management as Cost-Effective Approaches to Reliability Concerns, NARUC (July 23, 1999). See also, R.Cowart, "Efficient Reliability: The Critical Role of Demand-Side Resources in Power Systems and Markets," published by NARUC in June 2001.

[3] NACEC, Op. cit.

[4] U.S. Department of Energy. Energy Information Administration. *U.S. Electric Utility Demand-Side Management 1999.* http://www.eia.doe.gov/cneaf/electricity/dsm99/dsm—sum99.html

ports the creation of a federal public benefits fund to support these state-based programs.

The energy efficiency programs run by states in the 1980s and 1990s have been not only successful in their primary goal of saving energy, they have also been good for the economy. The Rand Corporation issued a report in 2000 that quantified the benefits of California's utility energy efficiency programs, finding that between 1980 and 1995, utility efficiency investments generated roughly $1000 in returns for every $1 spent. Rand also found that the overall economic benefit to the state from these programs was responsible for 3 percent of the California gross state product in 1995. A Public Benefits Fund would thus be an economic stimulus, helping to create jobs and new business opportunities in this time of economic uncertainty.

The fund would come from a non-bypassable charge on electricity, which would then go to match state expenditures on energy efficiency, low income programs, renewable energy, and state-based research and development. States are spending about $1.7 billion this year on public benefits programs, including efficiency, renewables, low-income programs, R&D, and related public goods. A federal match at this level would raise another $1.7 billion annually. The residential share of this would amount to about $12 per year per family-or about a dollar a month. Over time, the savings generated by the fund will likely drive the net cost into net savings.

The benefits would be enormous; they are projected to include: 130,000 Megawatts of electric capacity savings by 2020 (equivalent to about 400 powerplants); 1.24 trillion kWh saved over 20 years, cutting consumer energy bills by $100 billion; and 150,000 tons of nitrogen oxides emissions avoided.[5]

The public benefits fund is off-budget, providing an efficient way to support the states in their efforts to respond to their mandates for reliability, clean air, and affordable energy. A dollar a month is a very small price to pay for keeping the lights on, the air clean, and energy bills down.

An Energy Efficiency Performance Standard. The state of Texas has pioneered this approach in its electricity restructuring bill by requiring that utilities achieve a 10% reduction in their load growth forecasts. The energy efficiency performance standard would mirror this approach at the national level by setting a uniform national goal for energy savings that is implemented at the state level. The requirement to achieve energy use savings would apply to electricity retailers (or "load-serving entities"). They would report compliance to state utility regulatory commissions (or, in the case of public power, to their governing boards), who would be responsible for verification and enforcement. Federal agencies, including the Environmental Protection Agency and the Department of Energy, would set uniform national energy savings measurement and verification protocols, as well as guidelines for forecasting and reporting.

The uniform national standard would require each electricity retailer to arrange for and document modest, attainable, cost-effective savings as a percentage of sales and peak demand. Based on two decades of state and utility experience, a 1% target in terms of annual forecast electricity sales and peak demand is appropriate. Each year, electricity retailers would determine the energy savings that were achieved, according to the national protocols. Retailers would compare these savings to forecast sales, determine whether they met the 1% goal, and report this information to the utility commission.

The annual energy savings requirement would be cumulative. That is, each retailer would incorporate past savings into subsequent years' forecasts, and would achieve a 1% savings target for each succeeding year based on those forecasts. A 1% annual increase in energy efficiency is a fairly modest goal that is comparable to the savings that have been achieved under state demand-side management and other efficiency programs. To make compliance easier, the standards and reporting requirements could be set on a multi-year basis, as long as the overall cumulative savings target is met.

Electricity retailers would also have programmatic flexibility to meet the performance goal. The range of traditional and newer demand-side options includes approaches such as appliance and lighting rebate programs, new construction efficiency programs, real-time metering and pricing, performance contracting, consumer education campaigns, and low-income weatherization programs. The energy efficiency performance standard would also include a trading provision, which would allow a retailer that exceeded the standard to sell its excess "efficiency credits" to another retailer.

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[5] Alliance staff analysis based on: U.S. Department of Energy. Energy Information Administration. U.S. Electric Utility Demand-Side Management 1999. http://www.eia.doe.gov/cneaf/electricity/dsm99/dsm—sum99.html

Specific wholesale market rules that support distributed resource participation. Section 103 sets forth laudable goals and principles, but more specifics are needed to fully capture the potential for demand response, energy efficiency, and other distributed resources that this section seeks to encourage.

We recommend the Committee consider the following additional provisions in Section 103:

Demand-side Participation in Ancillary Service Markets. FERC should require that market rules allow demand-side resources to supply ancillary services on an equal basis with supply-side resources. The criteria for supplying ancillary services should be written in technology-neutral terms, and should not require costly telemetry and metering for individual demand-side resources whose performance could be verified on a statistical, aggregated basis.

An Efficient Reliability Standard. RTOs, reliability managers, and transmission owners often seek cost recovery in FERC-approved tariffs for investments intended to enhance system reliability. Before granting recovery in transmission tariffs or uplift charges that would recover those costs, FERC should require applicants to show that the benefits are broadly dispersed, and that they have selected the lowest-cost resource, including demand-side resources, reasonably-available to meet the need in question.

Before approving wholesale energy or transmission rates to recover the costs of a proposed reliability-enhancing investment in transmission facilities or ancillary services, the FERC should examine the relevant wholesale market and transmission access rules to ensure that price-responsive, distributed, and demand-side resources may compete on an equal basis with supply-side and transmission alternatives. It should require the applicant for cost recovery in rates to demonstrate that it has taken a "hard look" at transmission, generation, demand-management, and other distributed resources to meet the congestion relief or reliability need in question. Before approving such rates, the Commission determine whether:

(1) the relevant market is fully open to demand-side as well as supply-side resources;

(2) the proposed investment or standard is the lowest cost, reasonably-available means to correct a remaining market failure; and

(3) benefits from the investment or standard will be widespread, and thus appropriate for support through broad-based funding.

FERC Authority to Approve Regional Reliability Charges. While it is understood that distributed resources and demand management investments may be both quicker and less expensive means of enhancing reliability than remote central stations and new transmission lines, some observers question whether FERC has the authority to include the costs of demand-side and distributed reliability programs in wholesale rates and transmission tariffs. FERC should be given the mandate and the authority to recover the costs of traditional transmission investments AND non-transmission alternatives in rates.

FERC should, by rule or order, require jurisdictional transmission providers and RTOs to examine region-wide, reliability-enhancing investments in demand-side resources that would improve reliability and lower power costs. When supported by cost-effectiveness analysis, those utilities and RTOs should be permitted to recover those investments on the same basis as regional transmission investments, ancillary service costs, or other RTO expenses.

Standards for time-based metering and communication technology. The electric meter is the essential gateway through which many distributed resources are enabled, especially demand-response strategies. Without advanced metering capable of time-internal recording and digital communication, most customers will be frozen out of the market for many demand-side resource options. At present, the vast majority of users are neither aware that energy prices vary based on time of day nor do they have any financial incentive to shift usage to times of lower production costs. By varying prices by time of day, and by providing users with easy access to this price signal, users can shift usage and reduce their bills. The overall result is a more efficient market.

With advanced metering equipment, users can get the information they need when they need it and adjust their energy use not just to reduce their bill but to use less energy overall. This was demonstrated by Puget Sound Energy's efforts begun last December to provide time-of-use information to over 400,000 of its residential customers. Strictly an informational program at its outset, Puget has reported that 79% of its residential customers and 70% of business customers had taken action to alter their energy use and that 41% and 45%, respectively, reduced their usage. A recent survey showed that 89 percent of participants said the pro-

gram has encouraged them to shift some of their power use to off-peak hours. Forty-nine percent said they have cut their overall energy consumption.

Additionally, power-usage data indicate that variable, time-sensitive rates are saving energy as well as shifting time of use among Puget customers. Residential customers paying time-of-day rates shifted about 5 percent of their electricity usage, on average, away from the morning and early evening hours when public demand for power—and wholesale power prices—are highest. In addition, these customers reduced their overall electricity usage in June by more than 6 percent compared to their June 2001 usage.

Time-based metering and communications, and the new capabilities that it provides energy users, is an essential pre-requisite for the effective application of energy efficiency and demand response as resource options. It is thus important that Congress, support the acceleration of the installation, deployment and use of advanced metering and communications technology. We ask that the Committee require in Section 103 the development of uniform national metering protocols to ensure that the new market for interval metered data and time-sensitive information and pricing is created in a manner that is orderly, cost-effective, and not confusing or impractical. This will ensure that those who want to pursue demand response and related programs will not be thwarted by technology issues. The Alliance is working with companies in this field who are forming a coalition to advance policy that—accelerates the deployment of—these—technologies, and we will be pleased to offer the Committee further input as it moves forward on this issue.

It is also important that customers who want to use advanced metering not be thwarted by outdated utility rules. We thus urge the Committee to include provisions that ensure customers who want better metering are not prevented from doing so by distribution utility rules. With national protocols in place for metering, utility concerns about safety, accuracy, and security will have been addressed.

As with other new technologies for energy efficiency or sustainable energy use, it is important for Congress to provide financial assistance for more rapid deployment of advanced meters and demand response programs. We want to underscore our support for the tax credit included in H.R. 4 for advanced metering equipment as a vital stimulus for those who would implement the demand-response programs under Section 103.

In summary, energy efficiency, demand response, and other distributed resources are essential to a balanced electricity policy. We have offered several policy options, and we hope the Committee will give due consideration to our recommendations.

Thank you, Mr.Chairman, for the opportunity to share our views with the Committee today. I will be happy to answer any questions you might have.

Mr. LARGENT. Thank you, Mr. Prindle. Mr. Hyman.

Mr. SAWYER. Mr. Chairman, is it possible to break? I would really like to hear Mr. Hyman's testimony, but if I sit here and wait, I am not going to get my vote in.

Mr. LARGENT. The problem is that Mr. Hyman has to leave. It is my understanding that he can give his testimony, and we still will have time to sprint over there and vote.

Mr. SAWYER. Okay. We are not going to be able to ask him any questions anyway then.

Mr. LARGENT. Oh, that's right. Yes, we are not go able to do that anyway, no matter what we do.

Mr. SAWYER. I will read his testimony.

Mr. LARGENT. Do you have a question for him right now?

Mr. SAWYER. No, that's all right. Thank you.

Mr. LARGENT. Mr. Hyman.

Mr. HYMAN. I will be brief. I know that you are hungry.

Mr. LARGENT. Hold on, Mr. Hyman. Tom, do you have something specific that you want to ask him that maybe he could address in this statement right now?

Mr. SAWYER. No, I don't.

Mr. LARGENT. Okay. Mr. Hyman.

STATEMENT OF LEONARD S. HYMAN

Mr. HYMAN. Thank you. Payments to the transmission sector account for about 8 percent of the electric bill. Yet, transmission plays a crucial role in providing reliable service, and competition is not going to work if we don't have a robust transmission network that brings competitive power to consumers.

The transmission sector has not kept up with the expansion of the industry over the past 15 years. It is designed for the old utility era, and transmission expansion plans for the next decade seem even less adequate.

I am not proposing that we declare a problem, and then mandate a solution consisting of building so many lines of new transmission. We can employ new technologies that enhance the abilities of the network to handle more traffic.

We can encourage the network operator to find ways to operate the existing system more efficiently, and we can employ distributed resources and market-based incentives to consumers to reduce the stress on the network.

We can't do any of this, however, without a regulatory system that incentivizes the network operators to invest in the network, or to find the best operational solution. If all an incentive does is raise prices, it is not an incentive. It is just a give-away.

For the moment, I think the industry is mired in debates about processes, and governance, and how to form large entities. I don't hear very much about business plans or about customers.

And I don't really see how these organizations are going to expand their networks more effectively than the old power poles. These seem to be entities with one customer that counts, and that is the regulator, and that is not much of a change from the old regime.

Now, everyone wants to see the formation of transmission operators that are truly independent from market players. But I really don't see the regulators or the government officials getting to work on concrete steps that will remove a lot of the perceived barriers to structural separation of transmission from the rest of the utility.

There are very serious tax and accounting issues that can be dealt with and should be. I personally would rather see truly independent transmission systems whose sole business is serving transmission customers, rather than these convoluted structures that engender so much suspicion in the market.

Now, the proposed legislation addresses some of these issues. Section 202, for instance, makes it clear that utilities should not escape from the obligation to put their transmission under the control of an independent entity.

But it does not remove road blocks to really cutting the ties between the utilities and the transmission business, and it doesn't create an environment in which the transmission owner runs a company whose prosperity depends entirely on its ability to satisfy transmission customers.

And it does not deal with the disincentive to investment that could come about by placing one's assets under control of an entity that is not responsible for the commercial success of these assets.

Section 216 requires FERC to establish incentive rate making standards that would ensure reliability, as well as attract capital

for expansion, and this is long overdue. In other countries, utilities run on this basis.

And I think that incentive-based regulations could encourage the implementation of new technologies, and encourage innovative management in financial procedures. Incentive regulation, I have to emphasize those, has an upside and a downside, and that means that the firm that doesn't meet the standards comes out behind and suffers a penalty, and that's fine with me.

What I am not clear on is how FERC will give meaningful incentives to the transmission owners, the people who receive the returns, when the presumably non-profit regional transmission organization operates the system.

The incentives presumably should reward those who make the decisions in order to encourage better decisionmaking and the penalties should go to those who make the poor decisions, and right now there is going to be a disconnect.

Now, I think by focusing on specific customer friendly goals, and by encouraging the use of the regulatory framework that promotes an expandable and reliable transmission network, I think this bill should contribute to the development of more competitive markets and more reliable service.

And just as an add-on, even if you assume the most obscene returns to the transmission entities, it is only 8 percent of the bill. You don't really need to do very much. The customers would never notice. My own feeling is that they shouldn't notice.

I think it is imperative though that whatever system is devised, it has to have an incentive to attract capital for ongoing investment in the business. Thank you.

[The prepared statement of Leonard S. Hyman follows:]

PREPARED STATEMENT OF LEONARD S. HYMAN, SENIOR INDUSTRY ADVISOR TO SALOMON SMITH BARNEY

Payments to the transmission sector account for less than 10% of the electric bill. Yet, transmission plays a crucial role in providing reliable service. And competition will not work, if we don't have a robust transmission network that brings competitive power to consumers.

The transmission sector, however, has not kept up with the expansion of the industry, and it operates with a network designed for the old utility era. Expansion plans for this decade seem even more inadequate. I would not, however, propose that we declare a problem, and then mandate a solution consisting solely of building so many miles of new lines. We can employ new technologies that enhance the ability of the network to handle more traffic. We can encourage the network operator to find ways to operate the existing system more efficiently. And we can employ distributed resources and market-based incentives to customers to reduce stress on the network. We can't do any of this however, without a regulatory system that incentivizes the network operator to invest in the network or to find the best operational solution. Right now, we do not have that, and our regulators seem far away from proposing it.

For the moment, the industry seems mired in debates about the process needed to form large transmission entities and to determine their governance procedures. I do not hear much about business plans, or customer service, or specifics about how these organizations will expand their networks more effectively than the old power pools. These seem to be entities with one customer that counts: the regulator. That's not much of a change from the old regime.

Almost everyone wants to see the formation of transmission operators that are truly independent from market players. Yet I don't believe that regulators or government officials have yet to put into effect the concrete steps needed to remove the perceived obstacles to structural separation of transmission from the rest of the utility. I would rather see truly independent transmission systems whose sole business is serving transmission customers (which involves willingness to invest in new

wires, new technologies and even normal system maintenance), rather than convoluted structures that seem to engender suspicions in the market.

The proposed legislation addresses many of these issues.

Section 202 makes clear that utilities cannot escape from the obligation to put their transmission under the control of an independent entity, but it does not remove any of the roadblocks to really cutting the ties between the utility and the transmission business. It does not create an environment in which the transmission owner runs a company whose prosperity depends entirely on its ability to satisfy transmission customers. It does not deal with the disincentive to investment that could come about by placing assets under control of an entity not responsible for their commercial success.

Section 216 requires FERC to establish incentive ratemaking standards that would ensure reliability as well as attract capital for expansion. This is long overdue. Other countries regulate utilities on this basis. Incentive-based regulation could encourage the implementation of new technologies and encourage innovative management and financial procedures. Incentive regulation, of course, has an upside and downside. The firm that does not meet the standards comes out behind: that is, suffers a penalty. What I am not clear on is how FERC will give meaningful incentives to transmission owners, when the presumably non-profit regional transmission organization operates the system. The incentives, presumably, should reward those who make the decisions, in order to encourage better decision-making, and the penalties go to those who make poor decisions.

By focusing on specific customer-friendly goals and by encouraging the use of a regulatory framework that promotes an expandable and reliable transmission network, this bill should contribute to the development of more competitive markets and more reliable service. It is imperative, though, that whatever system is devised, there is incentive to attract capital for ongoing investment in the business.

Mr. LARGENT. Thank you, Mr. Hyman.

Mr. Johnston, are you ready to give your statement?

Mr. JOHNSTON. Yes, I am.

Mr. LARGENT. All right.

STATEMENT OF ROBERT JOHNSTON

Mr. JOHNSTON. My name is Bob Johnston, and I am here today representing The Large Public Power Council, which is a group of the 24 largest public power systems in the country, owning 44,000 megawatts of generation, and 26,000 miles of transmission.

First of all, LPPC would like to thank Chairman Barton for his support, continuing support, of the industry's private use relief needs, and we would also like to thank the Chairman for the PVA consensus language in the bill. Our members strongly support that language.

LPPC has supported comprehensive legislation for years, but at the present time we are unable to support H.R. 3406 in its present form. We have some major issues, and I would like to address three of those today.

Uniform refund authority, Section 702. LPPC has supported the FERC-lite industry compromise which requires us to offer open access transmission services to all parties at rates that are comparable to those that we charge ourselves, eliminating the potential for discrimination.

But it did not give FERC full rate making authority over our transmission, which has traditionally been at the State and local level. However, the uniform refund authority provision completely negates the FERC-lite provision because it gives FERC full authority to set the level of public power transmission rates, and to require refunds as it deems appropriate.

This is exactly what we thought we were avoiding when we bought into the FERC-lite compromise. The section also gives

FERC the authority to start proceedings to reset our wholesale energy rates for sales to jurisdictional entities and require retroactive refunds once FERC decides what the rates should have been.

This would be the worst kind of after-the-fact regulation, where we don't know the rules up front, and months or years later, we are told to make refunds. This simply doesn't work for public power.

When we make a sale into the wholesale energy market, those net revenues, if any, go directly back to our customers to lower their rates. If FERC comes back to me a year or more later and says make a refund on a transaction, what they are effectively doing is saying going to your end-customer and levy a charge.

That simply does not work and in effect the unintended consequence will be to remove much of public power's excess energy from the wholesale market, which I don't think is in the public interest.

Regarding RTO mandates, the bill gives FERC the authority to order public power transmission owners into RTOs, and I have a few points regarding this mandate. Basically, the first is that we don't feel that it is necessary.

Virtually every one of the LPPC's transmission owners, which represents the bulk of public power transmission in this country, already is in an ISO, has sponsored an RTO, or filed it, or is in serious negotiations with other utilities to create an RTO.

Furthermore, we have unique features that must get addressed as part of our negotiations into the RTO. We have tax issues, and bond indenture issues, State law and State statute issues, and probably, and most importantly, native load protection issues that have to get addressed before we can enter the RTO.

We are successfully addressing those issues through these negotiations that we are involved in, and I particularly—my utility in particular, SeTrans, negotiations are successfully addressing these issues if we could be allowed to complete that process.

However, if you put a mandate in place, you are effectively removing the incentive for the parties at the table to negotiate these issues. The bill in its present form does not require the RTOs to accommodate these public power issues.

Further, it does not require FERC to accommodate these issues. Therefore, if you apply the mandate, thereby removing the incentive to negotiate these issues, we don't believe that the issues will get successfully negotiated.

Public power will be the first to stand up and join RTOs if we can simply be allowed to negotiate these issues, and if the RTOs bring value, which is the last issue regarding RTOs that I would like to mention.

We need independent, comprehensive cost benefit analysis by region for the operating expenses and startup expenses of these RTOs so we will know the predictable costs and performance of these RTOs.

There is a big disconnect right now between what the actual costs and benefits that we are seeing incurred, versus the theoretical or philosophical debate regarding RTO cost benefits, and I want to give you a specific example.

The New York ISO originally estimated its operating costs would be $40 million. The costs today exceed $100 million. And that is five times the annual operating budget of its predecessor, the New York Power Pool, and these numbers are still increasing.

And this is not a unique situation. This is a common theme throughout the country. We estimate that over $1 billion has been spent to date in RTO startups and we are just getting started.

There will be billions more spent in startup, and there will be billions spent in operating costs, and we must be able to demonstrate to our governing bodies that RTOs will provide benefits to our consumers who will ultimately pay this bill.

Last, mergers. If you repeal PUHCA, we need to strengthen FERC merger authority, and not repeal it. Specifically, you should clarify FERC's authority to review holding company mergers and sales of generation facilities to protect consumers from market power abuse.

Thank you, Mr. Chairman. We appreciate you allowing us to participate in this. We look forward to continuing to work with you and your staff to develop these important energy legislation.

[The prepared statement of Robert Johnston follows:]

PREPARED STATEMENT OF BOB JOHNSTON ON BEHALF OF THE LARGE PUBLIC POWER COUNCIL

My name is Bob Johnston and I am the President and Chief Executive Officer of MEAG Power, located in Atlanta, Georgia. I am testifying today on behalf of the Large Public Power Council (LPPC), an association of 24 of the largest public power systems in the United States. LPPC members directly or indirectly provide reliable, affordably-priced electricity to most of the 40 million customers served by public power. We own and operate over 44,000 megawatts of generation and approximately 26,000 circuit miles of transmission lines. LPPC members are located in states and territories representing every region of the country, including several states represented by members of this Subcommittee—such as Georgia, Tennessee, Texas, California, New York, and Arizona—and include several state public power agencies as well.

Mr. Chairman and members of the Subcommittee, the LPPC appreciates your efforts to develop comprehensive electricity legislation. The LPPC has long taken an active and progressive role in supporting the development of a competitive, efficient wholesale power market of benefit to all consumers. We appreciate the efforts this Subcommittee has made to advance the debate on how to achieve benefits for electricity consumers and we would like to offer the Large Public Power Council's continued assistance in this process. During the debate on these issues in the last Congress, the LPPC provided our input to the Committee and contributed our views to the debate. This session, we have testified before the Subcommittee on three other occasions and have worked with members and their staff in a cooperative fashion. We appreciate the opportunity to continue our involvement. We appreciate the support the Chairman has provided for our agreement on private use. In addition, on behalf of our members from the Tennessee Valley, I want to make sure I thank the Chairman and the Subcommittee for including the consensus language in your bill. However, we have serious concerns other provisions with H.R. 3406, particularly with respect to (1) mandating the participation of public power in regional transmission organizations (RTOs), (2) subjecting public power to virtually all of FERC's ratemaking authority through the uniform refund authority provision and (3) the repeal of FERC's authority to review mergers and asset sales.

I would now like to comment more fully on the issues that are the focus of the Subcommittee's attention today.

PUBLIC POWER SYSTEMS ARE UNIQUE

What does it mean to be a public power system? Public power systems are owned by the communities we serve, not by investors. We are not-for-profit entities, which makes us different. Public power systems exist for a variety of reasons and were often created in response to specific concerns. Public power systems first appeared in the United States in the late 1800s and many were created as a part of the city

government. In fact, many LPPC member systems continue to provide additional services to their communities, such as flood control and natural gas, water and wastewater services.

Initially, electric service was used for public services, such as street lights, and was not generally available to residential customers. However, this changed rapidly and electricity became the essential service it is today. Electricity is a vital component of our lives now and, as was demonstrated in California last summer, a cornerstone of the economy. Consumers' confidence is shaken and there are dire consequences if electricity is not reliable and affordable. LPPC members are generally obligated to serve their native load customers by state law and, as a result, all available resources go first to serving those customers. Power is sold and surplus transmission made available only if it is surplus to those needs.

Our rates reflect the fact that we are not-for-profit entities. Our rates include only the costs of producing and delivering power to our customers and, in some cases, payments to our governing boards or municipal entities as a component of the local budget. Investor-owned utility rates are set to include profits paid to shareholders. Since public power systems are locally controlled, decisions about policies such as rates are made by people who are in touch with local concerns. The city council sets policies for many LPPC members, while other public power systems have a separately elected or appointed utility board that governs their policies. Local control helps ensure that we respond to community needs. In addition, since public power systems are community based, our revenues stay close to home. This helps keep the local economy strong. Moreover, the policies of public power systems are often designed to promote business participation and investment in the community.

My company, MEAG Power, was created by act of the Georgia General Assembly in 1975. Now one of the nation's largest joint action agencies and doing business as MEAG Power, the organization is the all-requirements wholesale electricity provider to 48 Georgia municipalities. These cities formed MEAG Power and issued over $4 billion in municipal bonds for the purchase of generation and transmission facilities in order to ensure reliable, economical electric service.

Another LPPC member system, the South Carolina Public Service Authority ("Santee Cooper") was established by the South Carolina legislature in 1934 "for the benefit of all the people of South Carolina and for the improvements of their health, welfare and material prosperity." Specifically, it was chartered because the state needed to build a dam on the Santee River, for flood and malaria control as well as electricity production. However, since the state lacked funds, the federal government provided financial assistance. The federal government required that the recipient of the funds be a state agency in charge of the project—and so, Santee Cooper was created. Since that time, Santee Cooper has functioned as an independent state agency, providing reliable electric services to the citizens of South Carolina at rates which are lower than those of other utilities in South Carolina and lower than the national average.

Public power systems have been created, in some instances, to resolve specific problems and address local concerns, filling a role that an investor-owned utility could not. For example, the Long Island Power Authority (LIPA) was established in 1986 by the state legislature to resolve a controversy over the Shoreham Nuclear Power Plant (Shoreham) and to achieve lower utility rates on Long Island. Created as a corporate municipal instrumentality of the State of New York, LIPA was authorized under its enabling statute to acquire all or any part of the securities or assets of the Long Island Lighting Company (LILCO) on a negotiated or unilateral basis and to issue lower cost, tax-exempt debt to finance the acquisition. LIPA was able to resolve the issues relating to the Shoreham facility and acquire LILCO's assets, as well as delivering significant rate reductions.

Public power is different from investor owned or cooperative utilities. We have a unique mandate and unique operating conditions, as well as some statutory constraints. These must be accommodated in regulation and legislation before public power can join in the effort to achieve consumer benefits through competition.

LPPC BELIEVES THAT THE IMPOSITION OF MANDATORY RTO MEMBERSHIP CONTAINED IN H.R. 3406 IS UNNECESSARY.

The LPPC opposes the concept of an RTO mandate for public power. Title II, section 202, of H.R. 3406 would provide the Federal Energy Regulatory Commission (FERC) with the authority to order all "transmitting utilities" to join an RTO. As you know, public power entities are not public jurisdictional utilities under the Federal Power Act. Congress established this jurisdictional line for good reason. In contrast to investor-owned utilities that seek to return profits to their shareholders, public power is an arm of municipal or state government, is subject to their over-

sight, has no shareholders, and is unambiguously devoted to serving its customers. This remains true today and, as a result, public power systems must answer to state and local governments for our actions. In addition, LPPC members have unique constraints on our ability to join RTOs.

Providing FERC with the authority to order public power systems into RTOs is unnecessary. Such an extension of FERC jurisdiction is also unwarranted. The vast majority of LPPC members are active participants in existing ISOs or in developing RTOs in their region of the country, as shown in the chart attached to my testimony. For example, our New York members, the New York Power Authority and the Long Island Power Authority, have been active participants in the New York ISO and are working to integrate that system into a larger Northeast RTO. Three large public power systems in the Southeast, MEAG Power, Santee Cooper, and Jacksonville Electric Authority, are participating in the discussions to create SeTrans in the Southeast RTO mediation. A number of public power entities have announced that they will participate in the development of transcos—specifically, the Salt River Project is participating in the development of WestConnect while Nebraska Public Power District and Omaha Public Power District will both join TransLink. LPPC members typically do not own keystone transmission assets that put them at the center of RTO development. However, public power wants to participate if it is not contrary to its customers' interests and the requirements of state and local law.

LPPC member systems are actively participating in the formation of RTOs. We must, however, stress again that there are legal constraints—such as private use tax restrictions, bond indenture requirements, and state statutory obligations—that are unique to public power, which must be addressed before we are able to participate fully in RTOs. If this legislation is enacted as drafted, public power systems will be mandated into RTOs without the flexibility to work through the constraints unique to public power and without the leverage we have in voluntary negotiations. FERC has required that transmission-owning investor owned utilities join RTOs. We accept and, in some cases, welcome the establishment of RTOs to support competition and we want to achieve all possible benefits for our customers. LPPC members, however, lack the size and scope to create our own RTOs. As a result, we must negotiate the terms of participation with investor-owned utilities so that our unique constraints are accommodated. For example, my company, MEAG Power, has participated in the discussions on a Southeast RTO—"SeTrans"—with other public power systems and investor-owned utilities. MEAG Power has an obligation under state statute to serve our native load and, therefore, our participation in SeTrans was predicated on an ability to preserve the capacity necessary to provide power to these customers. Through negotiations, we believe we will be able to grandfather in our native load obligations and obtain recognition of our pre-existing transmission rights. Under proposed SeTrans policies, we would not be required to curtail our native load unless all other mitigation measures have been attempted. This will allow us to fulfill our obligations to our customers imposed by state law. However, the same solution would not work for all public power entities. Unfortunately, actions at FERC or in legislation may undercut the voluntary efforts underway in many regions, e.g., the SeTrans RTO proposal in the Southeast, that have accommodated public power.

In a similar manner, two of LPPC's Midwest members, Nebraska Public Power District (NPPD) and Omaha Public Power District (OPPD), will join TransLink, an independent transmission company that will own and operate transmission facilities. Participants include both investor-owned utilities and public power systems. The members can either sell their assets to TransLink or lease them, in which case they will sign an operating agreement with the transco. NPPD will continue to own its own transmission—under state law, ownership by others is not permitted. NPPD also retains functional responsibility vis-à-vis its native load, another requirement imposed by state law. In addition, NPPD can override operating directions from the transco in the case of a public emergency.

However, were the participation of public power mandated, as provided for in H.R. 3406, these examples of transcos and RTOs would not have been created. In the Southeast, for example, the FERC administrative law judge recently expressed a preference for another model, GridSouth. If MEAG Power and other public power systems were under a mandatory obligation to join this RTO, we would be in violation of our state laws. GridSouth requires all participants to sign a uniform agreement for operation of the assets, or else the participant must divest itself of the assets. At least one of the public power participants in SeTrans, Santee Cooper, would be precluded from joining GridSouth due to the absence of the flexibility present in the SeTrans model. Under South Carolina law, Santee Cooper is only authorized to sell "surplus" property and must maintain assets sufficient to serve its local cus-

tomers. In order to joining GridSouth, Santee Cooper would either sign the uniform agreement which makes no accommodation for private use restrictions or state law constraints or it would have to divest its transmission assets. If participation in GridSouth was mandated, Santee Cooper would be in the untenable position of violating state law and operating contrary to its organic statute. This raises significant legal issues, whose resolution could add years to the process of RTO formation. However, the SeTrans model does not require that ownership of the transmission assets transfer to the RTO and allows contracts to be negotiated on a company-by-company basis, thereby allowing for the resolution of the unique challenges of public power in this region.

Simply put, since public power systems have retained the legal responsibility to meet the energy needs of their native load customers, they must maintain and retain resources to ensure the capability to supply such energy. Sufficient generation assets and assured transmission access are required to ensure that the energy needs of customer-owners are met in a reliable and cost effective manner. State and local laws place requirements on public power systems not present for investor-owned utilities. Unlike an energy marketer who wants firm transmission rights to support a sales contract, we must preserve adequate capacity to supply our customers due to an obligation to serve imposed by state law.

Finally, many of our members are concerned that RTO participation could lead to increased transmission costs and unexpected operating costs which would compromise our low-cost service to our customers. Provisions in H.R. 3406 ask for cost-benefit analysis to justify RTO proposals. We agree. Independent, detailed, cost-benefit analysis must be done to assure participants of predictable costs and performance which can be part of a proposed RTO. The New York ISO originally estimated that its annual operating costs would be $40 million. However, those costs are currently $100 million (five times the annual operating budget of its predecessor the New York Power Pool) and increasing. This results in significant charges to the members of the ISO and, ultimately, may result in a significant rate increase for their consumers. Public power would like to capture the benefits of competition for our customers, but we need to make assurances to our governing entities that consumers will not bear an inordinate cost burden. The LPPC believes that good cost-benefit analyses are necessary to assess the impacts of RTOs on the local or regional market and on the customer. The costs associated with the creation of an RTO or ISO are significant—the New York ISO incurred startup capital costs of $60 million and approximately $80 million was spent on GridSouth before the negotiations were abandoned. We want quantifiable benefits for our customers. We are concerned about startup and operating costs of the RTO or ISO. Without independent, detailed, quantitative cost-benefit analysis, we will have tremendous difficulty in assuring our governing bodies that these structures benefit our customers. Our ultimate objective as public power is to ensure reliable electric service at reasonable rates. Therefore, we urge the Chairman make certain that the benefits of RTOs and ISOs are quantifiable and will exceed the significant costs associated with their development, startup and operation.

We believe that mandating participation in RTOs by public power is unnecessary. The LPPC believes that this provision should be deleted from H.R. 3406. As noted above and in previous testimony, public power has constraints that limit our ability to fully participate in RTOs. Without resolution of the private use issues, accommodation of state and local statutory constraints, and preservation of our obligation to serve our native load, LPPC members cannot participate in RTOs. We have generally been able to address our concerns through negotiation and compromise on an individual basis and continue to believe that this is the optimal means for achieving the objective of a functioning, successful RTO.

FERC-LITE ISSUES

FERC-lite and Private Use

In the past, the LPPC has supported proposals to ensure that all market participants have access to the transmission system on a fair and open basis. "FERC-lite," as contained in Section 201, is such an open access policy. It would require public power entities to provide transmission services at rates that are not unduly discriminatory and require non-rate terms and conditions to be comparable to those required of the investor-owned utilities. However, as noted above, absent adequate private use reform, public power will be unable to provide open access transmission service due to the existing legal constraints. For this reason, our support for the "FERC-lite" concept is predicated on the removal of these legal constraints. We would ask that the bill include a provision recognizing this constraint and condition

adoption of the requirements of FERC-lite on public power on the resolution of private use issues.

While we recognize that this Subcommittee does not have direct jurisdiction over the private use issue, we appreciate the Subcommittee Chair's support of the industry consensus tax agreement that was introduced as H.R. 1459 by Congressman Hayworth. Earlier this session, the House passed H.R. 4, the Securing America's Future Energy (SAFE) Act. H.R. 4, as passed by the House, addresses private use issues, but contains a number of changes to the private use provisions of H.R. 1459 that frustrate the aim of opening up and expanding the transmission grid. The Hayworth bill represented a landmark consensus agreement between public power and investor-owned utilities forged at the request of Congress, and all parties believe it strikes an appropriate balance with respect to removing restructuring-related tax impediments. However, the private use provisions in H.R. 4 were modified in significant ways and these changes make H.R. 4's private use provisions unworkable—and in some respects, worse than current law—for public power. We ask the Subcommittee's assistance in ensuring that these key private use relief provisions are revised and modified so the original objectives sought by this agreement are achieved. We also ask that H.R. 3406 include language recognizing this constraint on public power and limiting our obligations until this issue is resolved.

Uniform Refund Authority Cancels out FERC-lite

The LPPC has very serious concerns regarding the provisions contained in Section 702 of H.R. 3406, which would amend Section 206 of the Federal Power Act. The "Uniform Refund Authority" provisions would allow FERC to set just and reasonable rates (and order limited refunds) for: (a) public power transmission to jurisdictional public utilities; and (b) public power wholesale sales to jurisdictional public utilities. This would largely negate the limitations on the Commission's ratemaking authority over public power transmission that are an integral part of Section 201 of the bill, known as FERC-lite. The Uniform Refund Authority provision would subject public power wholesale sales and transmission rates to review by FERC on FERC's own motion or whenever such rates are challenged under Section 206. While public power systems would be able to set their own rates in the first instance, these rates could, at any time, be reset by FERC. If so reset, the public power system could then be required to pay retroactive refunds. In our view, the "Uniform Refund Authority" provision, as drafted, cancels out FERC-lite and imposes unworkable, "after-the-fact" rate regulation on public power entities.

FERC-lite was designed to ensure that public power entities and cooperatives provide open access transmission services on non-rate terms and conditions that are comparable to those required of investor-owned utilities. However, while it required transmission rates to be non-discriminatory, it did not authorize FERC to set just and reasonable transmission rates for such entities. But, because Uniform Refund Authority authorizes FERC to set just and reasonable rates for any public power transmission to a jurisdictional utility, the FERC-lite limitations on FERC ratemaking are cancelled out. Section 702 should be deleted.

Uniform refund authority also applies to public power wholesale sales to jurisdictional public utilities. We believe that giving FERC this new authority is unnecessary and likely to discourage sellers from participating in the market. The uniform refund authority provision is backwards—rather than telling market participants what the market rules are ahead of time, it allows FERC to start up a regulatory proceeding, decide what the market rules are, and then apply them retroactively and require refunds for up to 15 months. This is no way to regulate.

These provisions also pose significant practical problems for many LPPC members. As not-for-profit entities, most LPPC members do not retain surplus revenues at the end of the fiscal year. For instance, MEAG Power operates on a one-year accounting system. Each year, any surplus revenues realized during the course of the year are redistributed and returned to our customers. Other LPPC members may return the surplus to their cities. What this means is that each year MEAG Power zeros out our books. As a result, were we required to issue a refund fifteen months after the fact, we would not have the "profits" to do so and would be required to either raise our rates or levy an assessment against our customers to obtain the funds.

FERC'S AUTHORITY OVER MERGERS SHOULD BE STRENGTHENED, NOT ELIMINATED

The discussion draft would repeal the Public Utility Holding Company Act (PUHCA). It would also repeal FERC's current authority to review investor-owned utility mergers and asset sales. If PUHCA is repealed, FERC's merger authority under section 203 of the Federal Power Act should be strengthened, not eliminated. FERC must be provided with adequate tools to review mergers, including holding-

company-to-holding-company mergers, and to prevent abuses of market power. The LPPC believes, at a minimum, that the draft should be revised to give FERC clear authority over holding company-to-holding company mergers and over generation-only transactions.

CONCLUSION

As the Subcommittee continues to move forward with electricity legislation, the LPPC offers our continued assistance. We would be happy to work with the Subcommittee and its staff to properly tailor FERC transmission jurisdiction to the unique structures and responsibilities of public power systems, ensure market power and merger protections for consumers, and retain the appropriate level of flexibility for FERC as it approves new RTOs. However, I must again stress that any comprehensive electricity legislation must meaningful private use relief—either in the same bill or in companion legislation from the tax committee—in order to be workable.

We look forward to working with the Subcommittee on comprehensive electricity legislation that addresses our concerns, garners wide support and can ultimately be enacted. I will be happy to answer any questions you have.

Participation by LPPC Members in RTO/ISO Development

Austin Energy	Participate in the ERCOT RTO, which is operational
Chelan County Public Utility District	Participating in RTO West discussions
Clark Public Utilities	Participating in RTO West discussions
Colorado Springs Utilities	Was involved in early discussions on DesertSTAR and currently reviewing TransLink and DesertSTAR proposals—no RTO activity currently in Colorado
Jacksonville Electric Authority	Sponsor of the SeTrans proposal
Knoxville Utilities Board	Not a transmission owner
Long Island Power Authority	Participant in New York ISO, which is operational
Los Angeles Department of Water & Power	Participated in the development of the California ISO Tariff; Key participant in the Transmission Access Charge discussions; Opted not to join California ISO
Lower Colorado River Authority	Participant in ERCOT RTO, which is operational
MEAG Power	Sponsor of the SeTrans proposal
Memphis, Light, Gas & Water Division	Surrounded by TVA; participates in RTO discussions to the degree TVA does
Nebraska Public Power District	Sponsor of the TransLink Transco which has filed a proposal with FERC; TransLink has agreed to join the MISO
New York Power Authority	Participant in NYISO, which is operational
Omaha Public Power District	Sponsor of the TransLink Transco which has filed a proposal with FERC; TransLink has agreed to join the MISO
Orlando Utilities Commission	Was involved in the RTO discussions of Grid Florida, which is on hold pending the Florida PSC hearing.
Platte River Power Authority	Was involved in discussions on DesertSTAR; no RTO activity currently in Colorado
Puerto Rico Power Authority	N/A
Sacramento Municipal Utility District	Opted not to join the California ISO until certain issues are resolved
Salt River Project	Participating in development of the WestConnect Transco proposal
San Antonio	Participant in ERCOT RTO, which is operational
Santee Cooper	Sponsor of the SeTrans proposal
Seattle City Light	Participating in RTO West discussions
Snohomish County Public Utility District #1	Participating in RTO West discussions
Tacoma Public Utilities-Light Division	Participating in RTO West discussions

Mr. BARTON. Thank you, Mr. Johnston. We appreciate you being here. I am tempted to ask for unanimous consent to move the bill right now since it is myself and Mr. Ganske here, and he is for the bill, or at least he was last week. So that wouldn't be right.

The Chair would recognize himself for 5 minutes of questions, or until other Members, in addition to Mr. Ganske, return. I have got so many questions that I really don't know where to start. I am told, Mr. Hyman, that you have to leave in about 5 minutes; is that correct?

Mr. HYMAN. Something like that.

Mr. BARTON. Okay. So let me kind of get you to square off against Mr. Rouse. Mr. Rouse says that we really don't need these incentive rates if I understood him correctly, that there is adequate transmission being built.

The Chairwoman of the Arkansas Public Utility Commission also said that she wasn't real sure that incentive rates were necessary, although she wasn't automatically opposed to them.

I am told that the demand for electricity is growing twice as fast as the announced capacity increases in transmission.

So it would seem to me that we need something to get more transmission built. So, Mr. Rouse, if we are not building the transmission that we need today according to all of the Department of Energy and Energy Information Agency, why not try incentive rates for transmission?

Mr. ROUSE. Mr. Chairman, I think the reason why we are not has more to do with what local opposition has——

Mr. BARTON. Well, now, the Chairwoman of the Arkansas Public Utility Commission said, hey, they are siting all these lines, and so do you think a little local opposition is stopping them?

Mr. ROUSE. Well, the local opposition will vary from place to place, and what we really need I think is not a wholesale massive additions to the system, but rather selected areas where we have low pockets. The PATH-15 was mentioned by Congressman Largent.

There are areas where we need new transmission to relieve congestion, and I think as the demand there is such that we don't need incentive rates to get that transmission built, we simply need either the oversight of FERC as a kind of last resort, or some way for the States and the local authorities to overcome local opposition.

Mr. BARTON. So you would just adopt the club them to death mentality, and let somebody come in and do it that way?

Mr. ROUSE. Well, I think the club, you say—the last resort would have to be that there should be some authority to recognize the need. But as far as incentive rates for the transmission, I don't think that would be necessary.

Mr. BARTON. Mr. Hyman, what is your response to Mr. Rouse's comments?

Mr. HYMAN. First of all, I think the numbers show that the capacity or the demand is growing four times as fast as the increase in capacity. Second, my attitude—the reason that I am proposing to use incentives is not necessarily to get someone to build a line.

I want to use an incentive to get this person to try to figure out the best solution, and if the best solution is building a line, fine. If the best solution is putting in some sort of facts device which actually increases the capacity of existing facilities, I want that to be the solution.

I want to create a tariff arrangement which causes the transmission company to find the best way to solve the solution for the customer, and that is the reason for the incentive.

Mr. BARTON. Now, let's go to Mr. Prindle. I thought that we were really encouraging distributed generation in our bill. You don't think we are. What would we have to do to get you to say yes?

In other words, how can I get you to marry my bill? What do we have to do, because I think we are really helping distribute generation, but you didn't think that.

Mr. PRINDLE. Well, we are focusing on energy efficiency here. We do recognize that there are certain provisions that do provide some encouragement for these kinds of technologies, and we do think that there are some opportunities that are missed.

Things like the performance standard, and the more detailed rules under Section 103, and things like that. It is a matter of degree, I guess.

Mr. BARTON. So if we were just a little more specific, you would like it better?

Mr. PRINDLE. Yes, a little more specific, and there is a couple of specific provisions that we would like to see added, sure.

Mr. BARTON. Okay. Now, let's go to my two good friends, Mr. Richardson, and Mr. English. I probably met with you two guys, or your association, about as much as anybody at the table, and I have had a good dialog.

I am not being facetious. I have enjoyed it. But you all were somewhat negative on the bill, to be polite, and I guess I would ask Mr. Richardson how do we have a national grid if we don't have mandatory participation in the grid, which seems to be one of the big bottlenecks from your group. You just don't want to have to be told that you have to join.

Mr. RICHARDSON. By mandatory, are you talking about national grid in terms of regional transmission?

Mr. BARTON. Yes.

Mr. RICHARDSON. I think that Mr. Johnston's comments were right on target, in terms of public power's participation. You look at the transmission owners and public power community, and they are participating in regional transmission organization.

Now, in terms of the mandatory participation, I think there are a couple of problems that I have tried to address in our testimony and in my comments. One is the very prescriptive nature of what is in the bill, in terms of its mandate and timing, and procedural obstacles that are available to——

Mr. BARTON. But I mean does your association—I would assume that there are those in your association that do have some interstate transmission capacity; is that correct?

Mr. RICHARDSON. There are some that have interstate transmission capacity, and there are some in my association that are completely transmission dependent. It makes for an interesting dynamic, but let me——

Mr. BARTON. I have only got 5 minutes, although I am the chairman. I can take more if I want to, especially since there are not all that many people here. But I want to get the concept. I want people to understand the concept.

We have been talking about a national grid for probably 10 to 15 years. Now, it is about time for the rubber to hit the road. We have kind of a least common denominator bill in the Senate, which is a great accomplishment for my friends in the Senate.

They have at least put out something. I love them for that. It is not comprehensive, and it doesn't address all the controversial

issues, and as usual, it is up to the poor old nitty-gritty House of Representatives to tackle the tough issues.

And one of the toughest issues is are we really going to have a national grid. Mr. Richardson, do you think we ought to have a national grid on behalf of your association?

Mr. RICHARDSON. Yes, I do. I think we need to rationale——

Mr. BARTON. Okay. Thank you. Mr. English, do you think we ought to have a national grid?

Mr. ENGLISH. Indeed.

Mr. BARTON. Okay. Now, there are two ways to do that, or three ways. We can make it voluntary, and just pray that everybody sees the same issue. We can put incentives, or we can go a combination of that, but ultimately make it mandatory.

Now, I have gone around that track every way I could. I have tried voluntary, and I have tried incentives, and I am now in the position after 3 years of being chairman of this subcommittee, I want to have incentives, and I want to make it voluntary, but at the end of the day, if you have to join, you have to join.

So we give you a year to join and work out the details, and participate however you want, but at the end of the year under the current bill, if you still haven't joined, the FERC can tell you that you have to. Now, with regard to the Co-Ops, we tried to make it as easy as possible.

Mr. ENGLISH. Well, we appreciate that, too, Mr. Chairman.

Mr. BARTON. And I was told that you had a conversation with the full committee chairman, and that on behalf of your trade association that you had a few minor things that you wanted worked out. Well, I listened for 5 minutes and you listed a number of minor things.

Mr. ENGLISH. Well, the point, and that is what I was attempting to get at, Mr. Chairman.

Mr. BARTON. Well, my time has expired. Answer the question and then I will go to Mr. Ganske.

Mr. ENGLISH. Well, the thing that I was trying to get at with what I was saying is that I think there is agreement on the objectives. Certainly there is from us as to what you are trying to do.

The point that we are coming down to is that we think that we are missing the mark in what we are doing. Now, you are talking about the emphasis with regard to RTOs, and the issue of how that is handled.

We think certainly that the Federal Energy Regulatory Commission obviously has to play that role. We think that there should be a lot of local involvement with RTOs.

Mr. BARTON. I agree with you.

Mr. ENGLISH. In other words, a lot of what we are talking about is process. A lot of what we are talking about also is this—and this is particularly true for us, is this big question of independence.

Are those RTOs truly going to be independent, and is FERC going to have the authority to make sure that they are independent, or are we going to be able to go in there and not be in effect taken over.

And that is what this—you know, we can talk about incentives, and we can talk about mandatory, and we can do this, and we can

do that, but the real hang up that we are into is this question of is it really independent. Is FERC really going to make sure——

Mr. BARTON. That the RTO is independent?

Mr. ENGLISH. Exactly.

Mr. BARTON. Okay. Well, we can work on that. My time has expired. We recognize Mr. Ganske for 5 minutes.

Mr. GANSKE. Thank you, Mr. Chairman. About a week ago I gave a talk at the Des Moines morning rotary, and I asked the 150 people that were there how many of them either through their mutual funds or individual investments had an exposure to Enron.

And about two-thirds of the people raised their hands, and so I want to pursue this a little bit. I thank all of you for coming, and Mr. David Sokol, I thank you, from coming from the Midwest.

Mr. Sokol, your testimony says that the problems with Enron shouldn't stop us from doing electricity legislation because these problems are primarily about bad investments and misuse of accounting. Do you have any personal expertise to base this on, or is that just your conjecture?

Mr. SOKOL. Thank you, Congressman. Unfortunately, yes, I do, both directly with Enron, but more sadly in 1992, I was asked to become president of the company that 4 months later I turned into the SEC for serious accounting fraud that had been perpetrated over a 5 year period.

And the Enron situation, being an active participant in the markets both that they participate in nationally, as well as directly in the midwest, the energy markets have not been disrupted at all by Enron's bankruptcy.

Certainly banks, and unfortunately employees, and shareholders, and many of the creditors of Enron, have been severely impacted. But it is not an issue relevant to 3406. It is, however, and on behalf of both myself and Mr. Buffett, who takes these issues very seriously, changes need to be made, because I think a follow-up effect of when a corporation the size of Enron is caught doing what it has been doing, falls as fall and as fast as it has done, it cannot help but harm confidence in the United States securities markets.

And that is an issue that may not be relevant in today's hearing, but it is unquestionably important to be acted on quickly, and again Enron is not unusual. JWP, the company that I mentioned, Waste Management, Sunbeam, and many others, we have lost the obligation to follow not only the letter of accounting, but the intent of accounting.

Mr. GANSKE. Mr. Sokol, I think it is really important to distinguish between Enron and the companies that are represented at your table. I wondered if you could expand on that. What is the difference between your company and Enron, or the other utility companies?

Mr. SOKOL. Well, first of all, I think it is important to make a difference. First of all, the Public Utility Holding Company Act, which is a discussion that has been part of this conversation, did nothing to stop Enron from doing what it was doing.

It did nothing to stop PG&E from going bankrupt in California, and it did nothing to stop Southern California Edison from being bankrupt in California. Enron is an independent power company, and it happens to own a utility in Oregon.

I think it is important to note that the only two assets that Enron owns of any substance today that are not bankrupt is Portland General Electric, which was protected by the State Regulatory Commission in Oregon, and not PUHCA, and interstate gas pipeline systems that Enron owns that are also regulated by FERC and certain State regulatory bodies.

And what Enron did, and by the way, what Enron has done is not unique in our industry. And it is not unique in a lot of industries, and it needs to be considered and looked at carefully.

They inflated earnings inappropriately, and they used off-balance sheet treatments to avoid rating agency scrutiny, and perhaps many other activities that we are not yet aware of. I don't believe that the regulated utilities in this country participate in those activities.

If they do the management and their auditors should be fined and go to jail.

Mr. GANSKE. So, as we look at repealing PUHCA—I mean, what kind of assurances can we give consumers?

Mr. SOKOL. Well, PUHCA actually—and with all due respect to the U.S. Congress, we have been talking about repealing PUHCA for 18 years. PUHCA and the distortions that are created by outdated and ineffective regulation are what create the opportunities for the kind of accounting abuses and misuse of markets that you are seeing with Enron.

PUHCA has nothing to do with having stopped that. What it does stop is credible players like ourselves and others from being more involved in the industry, and frankly helping stop things like that from happening.

It had nothing to do to stop it, and it didn't stop it, but the provisions of 3406 would in fact help stop it by actually making access to all the books and records of every holding company in the United States available to those State regulators.

As an example, Portland or the State of Oregon could have asked for the books and records of the rest of Enron underneath 3406. They did not have the right to under today's regulatory regime with PUHCA in place.

Mr. GANSKE. So let me just repeat that. Your contention is that had the chairman's bill been law that it might actually have helped prevent the Enron problem?

Mr. SOKOL. I believe that's correct.

Mr. GANSKE. Mr. English, did you want to make a comment also?

Mr. ENGLISH. I did. I think there is something that we may be missing here a bit on the Enron thing, and I am going to agree with you. I don't think that PUHCA obviously didn't prevent Enron from happening and so forth.

But the issue that we have got moving into this environment is—and certainly the COMPACs that our members have had, and the impressions that we have gotten, you are dealing with a bunch of folks that were swashbucklers.

You were dealing with a bunch of folks that quite frankly were arrogant, and you were dealing with a bunch of folks that were going to do it their way because they thought they had this thing all figured out.

And whether there were laws broken or not I have no idea, but I think that certainly as we get into this kind of a marketplace with competition in what has been previously been a regulated industry, I think it does attract that element.

And I would suggest to you that if you are going to repeal PUHCA, then you darn well better put something in place to protect the consumers, or you are going to have more of this kind of activity just because that is the kind of folks that are attracted to this kind of a marketplace.

Mr. GANSKE. So you would agree with Mr. Sokol that the transparency provisions in this bill are pretty important?

Mr. ENGLISH. Well, I think we need to go further. I think that we need some good solid consumer protection version. I think we need to have an exchange. If you are going to repeal PUHCA and say that PUHCA no longer is relevant here, then you have got to have some solid consumer protection to make sure that they are protected against this element.

Mr. BARTON. The gentleman's time has expired. We may have time to come back for a second round.

Mr. GANSKE. Thank you, Mr. Chairman.

Mr. BARTON. The gentleman from California, Mr. Waxman.

Mr. WAXMAN. Thank you, Mr. Chairman. Mr. Prindle, thank you for your testimony today. I know that you and The Alliance to Save Energy are widely respected for your expertise on these matters.

It is critically important for all of us to understand why the current structure of our electricity system often discourages efficient use of energy, and why restructuring will make that problem worse.

Would you please walk us through what has happened to investments in energy conservation over the past decade, and would you also explain how the market structure encourages us to expand transmission and generation even where conservation measures would be a less expensive way to meet demand.

Mr. PRINDLE. Well, certainly. As I mentioned in my testimony, over the last 5 to 6 years, we have lost half of the investment we used to have in energy efficiency programs, and that is largely because States backed away from their former commitments to integrated resource planning, in which the utilities were vertically integrated monopolies.

And there was a logical framework in which if you wanted to build a power plant, you could do analysis to see if there were demand-site options which were more cost effective before committing to that capital investment.

Well, now with restructuring, we have a virtually fully deregulated generation sector in which a utility at the State level can't really say anything about generation, and can't even determine an avoided cost for generation because the utilities that it regulates don't own generation.

So we have essentially lost the framework that used to exist that allowed for the kind of planning to make rationale resource decisions. Right now in the generation markets there is an active disincentive for generators to save energy.

And in fact if you look at California's market, there is a lot of evidence that very high demand and very peaky demand actually

increases revenues to generators, and it encourages market behavior to maximize that effect.

Unfortunately, over the last summer, we have seen an 8 percent drop in demand in this State because of energy efficiency and other kinds of investments that have really taken the rug out from under that kind of supply oriented behavior.

So we clearly need that kind of risk management if you will on the demand-site to offset the inherent disincentive that exists in the wholesale markets as they are today.

Mr. WAXMAN. Do you see anything in this bill to either provide funds for investments in energy efficiency or establish requirements to improve energy efficiency?

Mr. PRINDLE. Well, we don't see enough. In Section 103, there is a provision to require FERC to foment the proliferation of demand response programs, and we think that is a positive thing.

However, there is nothing specifically that enables energy efficiency to participate in those demand response markets. So, we have offered some specifics to encourage that. But beyond demand response, we think there is a need for a broader approach to encourage energy efficiency and related resources.

Mr. WAXMAN. If we don't have a broader approach, and if we don't have other substantive measures in legislation, can we really expect to overcome the market barriers to energy conservation that you have discussed?

Mr. PRINDLE. Well, not the way that markets are running now. As I have said, generators only make money when sales go up, and the same is true for distribution companies as long as States continue to use a through put base regulation in which volume of sales determines revenues and profits.

Some States have gone to a different form of performance-based rate making where that is not the case. But right now most distribution companies again are net losers in energy efficiency programs.

Mr. WAXMAN. Well, we heard from the administration yesterday that they support energy efficiency, renewable energy, and environmental protection. And Mr. Blake pointed to some provisions in this bill as furthering those goals.

But in your opinion they are not enough?

Mr. PRINDLE. We certainly would like to see more in the bill, yes.

Mr. WAXMAN. I was disappointed that the majority did not grant our request to invite a witness to speak about renewable energy today. This bill directly addresses renewable energy, but only in a negative way. It would repeal Section 210 of PURPA, which has allowed renewables to start to compete in energy markets.

And since we don't have a renewable energy witness here today, I would like to ask you, Mr. Prindle, does anything in this bill either provide funds for renewable energy, or establish requirements to develop renewable energy?

Mr. PRINDLE. Well, I am not a renewables expert, and The Alliance has no specific position on that. We do work with a lot of our colleagues in the renewables world through the sustainable energy coalition, and we are equally disappointed that those folks were not invited to testify.

And we would suggest that at a future hearing that those folks be included in the discussions.

Mr. WAXMAN. If I might just take another second or so. The administration agreed yesterday that they thought that the legislation should support renewable energy. Instead, I think the bill would increase our reliance on old and polluting energy sources.

It is a critical topic, and it deserves more attention. Mr. Alden Myer, of the Union of Concerned Scientists, is a renowned expert on renewable energy, and I would like to ask for unanimous consent to insert his testimony into the record.

Mr. NORWOOD [presiding]. Without objection, so ordered.

Mr. WAXMAN. And I want to conclude by pointing out that a new study by the North American Commission on Environmental Cooperation demonstrated the link between electricity restructuring, increased demand for electricity, and increased air pollution.

And I think that we ought to keep that in mind, and I was disappointed that we didn't have any part of this hearing devoted to the air pollution consequences of energy legislation. So I want to make that point for the record.

I would ask you some questions about it, Mr. Prindle, but I have run out of time. But I assume that you agree that there is an air pollution consequence to energy policies, and we ought to realize that there is an interconnection between the two?

Mr. PRINDLE. Absolutely.

Mr. WAXMAN. Thank you, Mr. Chairman.

Mr. NORWOOD. I would now like to recognize Mr. Walden for 5 minutes.

Mr. Walden. Thank you, Mr. Chairman. I would like to follow up on one of these issues of energy efficiency. I know that I have been in small business for nearly 16 years, and every light socket that will take a fluorescent light bulb I have put in.

And I know that a lot of people are doing the same thing in their homes, and looking for other energy efficiency. Hasn't energy efficiency actually gone up, Mr. Prindle?

Mr. PRINDLE. The question is whether energy efficiency has gone up?

Mr. Walden. Yes. Isn't the market responding, and aren't consumers responding?

Mr. PRINDLE. Well, in the State of Oregon, it is, Mr. Walden, largely because there has been a 20 year history of investment through the municipal utilities, and the Bonneville Power System, and the Northwest Power Planning Council, and now the new Oregon energy trust.

There is a sustained and now even an increasing commitment to implementing the fundamental policies and creating the incentives, and the market transformation programs. But in most States, we don't have that.

Mr. Walden. Okay. But I also know that one of the things that spurred me along, and some of my neighbors, was a proposed increase of 46 percent by Bonneville. That kind of gets our attention more than a—I mean, I am participating in some of the State programs, too.

We replaced a washer and dryer, and the Energy Star Program provides for some tax benefits for buying upscale dryers basically, and you are going to save on energy in the long run.

But it just seems to me that the market also plays a role, and I am a very strong advocate, and in fact I supported one of Mr. Waxman's amendments last spring to make more use of renewables, and demand-site reduction issues are a concern as well.

One of the troubling parts for me in this bill and in general is that, one, there are the 29 States out there that have the so-called net metering programs that have engaged in some of these other programs to reduce demand and provide for efficiency.

And I want to make sure that we don't upend their apple cart through this. But beyond that, it is just the philosophical debate about demand reduction. You can only go so far before you shut down your economy, because if I am in business and I make more money by selling off the power that I don't consume, and not operating the plant that I have, I may be forced to do that from a financial standpoint.

But it doesn't do much for our economy does it? And I think we have to be careful about how much we put on that side, as opposed to creating more generation opportunities, and a grid that works.

Mr. PRINDLE. That is a very good question, and we are very committed at The Alliance to working with the market. We have 70 associate members, many of whom are the major manufacturers of energy efficient technology.

And I can say that the analysis that has been done does show a net positive impact on the economy from energy technology. For example, The Rand Corporation did a study of California's efficiency programs, and found that for every dollar invested in efficiency that a thousand dollars on net came back into the economy.

And, in fact, in the year 2000, about 3 percent of the gross State product was related to investments in efficiency. So we believe that energy efficiency and a growing economy actually go hand-in-hand. And our efficiency performance standard doesn't purport to stop economic growth, but only to mitigate the rate of electricity demand.

And we have seen this over the last 25 years in the economy with a 40 percent increase in GNP with almost flat energy growth.

Mr. Walden. So there has been.

Mr. PRINDLE. And the key here is to keep the economy growing while moderating demand growth so that we can put the cap over——

Mr. Walden. Well, I guess that is what I was getting at initially. I thought I had read where there has been fairly extraordinary energy efficiency, but my biggest concern is that we are going to end up at some point in a recession and a snapback that we are going to be right back to where we were last spring talking about blackouts again, and lack of energy supply if we are not careful.

And so I want to make sure that what we do in this bill gets us a grid out there that will work, and a marketplace that will function that won't end up sticking the consumers along the way.

And that gets us to some of the issues about the RTOs and I would be curious to hear what you have to say as to that. I know that I have heard from some of my co-ops. And I apologize for not

being here for all of your testimony, but I am curious as to your comments on that.

Mr. ENGLISH. I think that an assurance that it is clearly independent. I think that the regulation is there and in fact the emphasis is there in enforcement—and the concern I think is that they are going to be swallowed up and they are going to be taken over, and they are going to have their assets used in a manner that is contrary to their best interests.

And so that's where time and time again we hear this concern arising and I don't think that emphasis is there in this legislation, and I don't think we are seeing that emphasis as far as FERC at this particular point in time, not to the degree that we would like.

Mr. Walden. My tine has expired, Mr. Chairman. Thank you.

Mr. NORWOOD. Thank you, Mr. Walden, for those very insightful questions, and ending on time. Now I would like to recognize my friend from Ohio, Mr. Sawyer, for 5 minutes.

Mr. SAWYER. Thank you, Mr. Chairman. Mr. Gent, NAERC is the sector coordinator for the electric industry under the President's Commission on Protection of Critical Infrastructure for 1996. You just came out this past spring with a report and recommendations.

But adherence to those recommendations is voluntary, as with most recommendations. Are you satisfied that there is sufficient voluntary progress in meeting those recommendations?

Do you think that it would be appropriate to build a more defined and perhaps mandatory role for an electric reliability organization to have the authority to enforce standards for protection of critical infrastructure?

I mean, we have heard a great deal of talk about generating capacity, particularly nuclear and fuel storage dumps around the country as weapons in place. But I am frankly just every bit as concerned about the vulnerability of the grid to this sort of thing, and I was wondering if you could comment on that.

Mr. GENT. Mr. Sawyer, the solution is right here in your legislation. I think that the self-regulating reliability organization can be extended into including national security interests.

I have heard a lot from the Department of Energy and other government agencies talking about standards. We have yet to define what they would like to have as standards. But should we decide as a Nation that we want to have some kind of security standards, uniform security standards, for energy facilities, we think that needs to be debated in an open way.

And once the standards are implemented, they need to be mandatory. I think industry itself is in the best position to enforce those standards. There would have to be government oversight like there is in all SROs. But I think that what you are proposing in your legislation would do that also.

Mr. SAWYER. Critical vulnerabilities, and just identifying them is an incredibly important first step.

Mr. GENT. Yes, and it is also critically important that we don't create a list so that everybody knows what those are.

Mr. SAWYER. I understand. Thank you. Mr. Sokol, I wish Mr. Hyman were still here, but let me ask you. You suggested that we direct FERC in your testimony to review its transmission pricing policies, and you spoke about that a little bit.

And yet we heard from FERC yesterday that they think that they have the authority to do what needs to be done, although they wouldn't mind having a little bit of additional emphasis on that restate of direction.

Could you give us a sense of how you think innovative pricing policies would work in the business of developing the kind of ongoing reliable capital investment that the grid needs, and the kind that Mr. Hyman talked about, and why you think that FERC may have been so far reluctant to act on the authority that they believe that they have?

Mr. SOKOL. Well, first, Congressman, I strongly agree with what I think is one of the most important elements of this bill, is dealing with transmission, because we do have a vulnerable transmission system, both purely as an energy delivery system for this country, remembering that it was brown from a patchwork quilt, and not as a national system.

It grew together and it did not grow intelligently.

Mr. SAWYER. He sounds like me 4 years ago doesn't he?

Mr. SOKOL. That's a compliment. Thank you. The issue of incentive pricing, first of all, should not be taken as an absolute in our view in any sense other than the recognition that as you move from a patchwork quilt of 1,800 participants owning transmission in this country, to 5 or 10 RTOs, or whatever the right number is, that you have got to find a mechanism to incentivize the construction of transmission that may not be an obvious need.

As an example, in our area, we could make additions to transmission that would allow the power to be moved to several other States, including Iowa, to Kansas during certain peak times because of the way that load shifting has occurred over the last 20 years.

There is today no mechanism for us to be compensated or any of the other three participants, one of which is a public power agency, to be compensated for making that addition if that power doesn't flow; i.e., a cooler summer, and Kansas City doesn't necessarily need the power flow.

It may, however, be an absolutely essential piece of a redundant, highly reliable grid system that that transmission piece be made.

And what we are really speaking to is merely that traditional forms of finding the capital to do that may need to be enhanced, whether that is an incentive or whether or not it is merely the recognition at State and Federal levels that putting in $100 million here may provide something that doesn't have direct compensation tied to it, but national security issues.

It is a reliability issue and things of that nature. So I think that giving FERC that ability and perhaps us all working harder to prod them to use it where it is necessary, and explain the reasons for it, is ultimately in the consumer's interest. And whether we make the investment or someone else does is really irrelevant from our standpoint.

Mr. SAWYER. Just an observation, Mr. Chairman. It seems to me that those kinds of investments, carefully done, and appropriately compensated, can go a long way toward getting rid of the kinds of price distortion practices that we saw recently caused by transmission bottlenecks. Thank you, Mr. Chairman.

Mr. NORWOOD. Thank you very much, Mr. Sawyer. I would like to now, and it is a pleasure now, recognize a gentleman from New York for 5 minutes.

Mr. FOSSELLA. Thank you, Mr. Norwood. For Mr. Gent from NAERC, and I guess a question from a New York perspective. Currently there are special rules in place for the Metropolitan region in New York City in order to be able to quickly respond to any disturbances in the transmission system, and reduce the likelihood of blackouts.

The rules include such things as temporarily reducing the level of imported energy, and starting up expensive gas turbines in the Metro region, and fuel switching at certain generating stations.

They are overseen in some cases by the Public Service Commission, and maintains a detailed familiarity with the specifics of the New York system. I say that because as I see one of the suggestions that NAERC makes is that there will be a national standard.

And I am just more curious as to how you would envision this one national standard, and its relationship to what New York City, given its unique circumstances, what that relationship would be?

I guess what I am saying is that there is a sentiment that we don't want to see those standards or rules relaxed, and that the standard that is ultimately implemented on a national level lower than that, we would just be curious as to how New York City would fare?

Mr. GENT. Congressman, I can assure you that we don't want to see lower standards for New York City either. NAERC was born out of the first Northeast blackout, which centered around New York City.

And then there was the blackout of 1997 that gave rise to the standards that you are discussing. The legislation as it is proposed has allowances for special situations in various regions.

And whether it be a variance or not, there will also be conditions where somebody will have a better idea for accomplishing the same performance. And so that is all provided for in the way of variances.

We have had long discussions with people from New York State, and we think that their needs and concerns can be accommodated.

Mr. FOSSELLA. So New York will basically have the flexibility to maintain its own standards separate and apart from——

Mr. GENT. Yes, as long as there is ample demonstration that they are not endangering the rest of the grid, which in this case that's not the case, they will have standards that would be acceptable to the rest of the interconnection.

Mr. FOSSELLA. Okay. Thank you. That's all.

Mr. NORWOOD. I would recognize the Ranking Member, Mr. Boucher, for 5 minutes.

Mr. BOUCHER. Thank you very much, Mr. Chairman. We all acknowledge that we need to build new transmission lines in various parts of the Nation, and there are some substantial differences of opinion as to the proper approach for Congress to take in order to encourage that.

The bill that is before us contains provisions for incentive pricing for new transmission, and that is controversial in the minds of

some, on the theory that incentive pricing necessarily means higher pricing, and that has a direct effect on electricity consumers.

Others may take the position that the market can be relied upon to attract the capital necessary for new transmission line construction, and perhaps RTOs should be affirmatively empowered to take whatever steps are necessary to bid out the construction, and to manage the construction, and perhaps even to own the new lines.

And I would welcome views from our witnesses, perhaps starting with Mr. Richardson and Mr. Hyman, to talk about the validity of that latter approach. First, I know Mr. Richardson has some problems with incentive pricing, and you might briefly comment on that and tell us what they are.

But more to the point, I am interested in knowing whether the capital markets can be relied upon to supply the funding that is necessary in the event that RTOs undertake the responsibility of building lines.

That strikes me as a very interesting approach if it has merit, and I would be interested in knowing if it has merit. So, Mr. Richardson, let's begin with you.

Mr. RICHARDSON. Thank you, Mr. Boucher. Yes, we do have problems with the incentive pricing provisions. Thus, what this suggests is prices that are in excess of or rates that are in excess of just and reasonable rates that are currently authorized under the Federal Power Act.

And that as I said in my opening comments, just and reasonable is a zone. It is not a fixed point. And it is set within that zone to compensate for the risk of the investment itself, and we think that gives the Commission sufficient latitude to encourage through rates new transmission facilities.

The suggestion that you raised with respect to regional transmission organizations and bidding out the construction of new transmission facilities is one that I think makes a tremendous amount of sense.

There are individual owners of transmission facilities who have reasons not to build transmission or to maintain constraints because it is in their economic interests to do so, and that is a problem that needs to be overcome.

There is transmission that needs to be constructed because it is in the public interest to do so. Yet, it may not be in the economic self-interest of any single participant.

But it is in the regional interest, and Mr. Sokol pointed out an example of where that could well be the case. If you have a regional transmission organization that has the authority to bid out the construction, there is money in construction, and you certainly find people to construct if you can get over the siting problems.

You could certainly raise the capital because we have been able to raise capital for transmission facilities, including the noted constrained PATH-15 in California under the current regulatory regime.

And those facilities could then be owned by the regional transmission organization, and rates set system-wide for that organization, sufficient to cover the depth that was issued. So that seems to me to make a lot of sense.

Mr. BOUCHER. That is the answer that I was hoping to hear. Let me ask you this. Do we need to do anything legislatively in order to enable RTOs to exercise that bid out and then construct opportunity?

I think that some States may have statutes that say that the only entities that can build transmission are the certificated and regulated utilities. Are you aware of this circumstance?

Mr. RICHARDSON. I am not aware of that. Obviously, a backstop would be to specifically authorize if it is in the public interest for the Commission to do so to allow regional transmission organizations.

Mr. BOUCHER. Okay. That's fine. Thank you. Mr. Hyman, let me ask you this. You heard the proposed structure here—oh, I'm sorry. Your nameplate says Mr. Hyman.

Mr. PRINDLE. Mr. Hyman was sitting to my left.

Mr. BOUCHER. I see.

Mr. PRINDLE. But if the Congressman would indulge me, I do have something to say about that.

Mr. BOUCHER. I would be happy to hear what you have to say. Please.

Mr. PRINDLE. Well, our forte is energy efficiency and not transmission, per se. But we do work with companies that are in the transmission technology business. And as most people know, there are enormous losses in the transmission system.

The old steel core transmission lines that have been out there since the 1930's are inefficient. They lose enormous amounts of energy, and they cause lines to sag, and hit pine trees, and cause outages. That is what almost caused the whole Western system to go down a couple of summers ago because a line sagged and hit a tree.

There are new technologies, like composite materials, out there that can increase the through put of transmission lines substantially. But in order to do that, there have to be incentives out there to invest in those new higher efficiency technologies.

And so just another way of supporting the idea that some sort of incentive needs to be there to encourage efficiency within the transmission system, as well as the construction of new lines.

Mr. BOUCHER. Okay. Yes, Mr. English. We will conclude with you.

Mr. ENGLISH. Very, very quickly, I just want to make the point, two things. One is we need to establish Federal standards with regard to transmission lines, and new transmission needs to be built of those standards.

Second, I don't believe that we have looked at the question of why transmission is not being built. There are a whole host of reasons. And third is we ought to open it up and let others build transmission other than the established utilities, and invite others to come in and build this transmission and get it done. And, fourth——

Mr. BOUCHER. Including RTOs?

Mr. ENGLISH. Yes, indeed. Indeed. And, fourth, I think we get down to the whole question that incentive rates, if any money is going to be derived out of incentive rates, they must be used to build new transmission and not for any other purpose.

Mr. BOUCHER. Okay. Thank you. Mr. Chairman, my time is up.

Mr. NORWOOD. Thank you, Mr. Boucher. I now recognize myself for 5 minutes. I would like to thank all of you lady and gentlemen for being here, but I particularly want to thank Robert Johnston for being here from Georgia.

These types of little gatherings are always very helpful to us. I am sorry that Chairman Barton has already left, because my first question was to him as he was talking about incentivizing people to go into RTOs, I wondered if he would define incentive.

They can be negative and they can be positive and it is going to be very important in my view which way we try to encourage people to do that. Perhaps all of you know that yesterday we had the FERC Commissioners here, and Chairman Wood, and we had some rather lengthy discussions regarding FERC orders and studies, or maybe the lack of studies.

Now, Mr. Johnston, I want to talk to you specifically about RTOs just for a minute. I am very concerned—and part of that is that many of my constituents seem to be very concerned—about what the bottom line is going to be; what effect these RTOs might have on rates.

With respect to some of the FERC policies, I think it is for sure that they have not measured cost benefits in regards to these RTOs. Are you aware of any cost benefit studies that Chairman Wood has conducted on the issue of RTOs?

Mr. JOHNSTON. I believe that they have recently initiated cost benefit studies at the urging of many in the industry, and those are underway. I don't believe that there have been any impartial independent comprehensive studies done to date that I have seen.

Mr. NORWOOD. Well, he indicated that perhaps that would be in our future, but things are moving pretty fast. I would like if we are going to do that, I would like to see it done as soon as possible.

Is it possible that RTOs may not be as effective in some regions of the country as they might be in other regions of the country? Does this concern you, and if it does, now is a good time to talk about that.

Well, we have said that those studies need to be regional and the reason they need to be regional is that we have different cost structures, and different transmission needs, and different issues regionally.

And I know in particular the LPPC members in the Northwest, and in the Southeast as well, both being low cost regions have concerns about out of control costs for the RTO without corresponding benefits to offset those costs.

And when you are in a low cost State, it is a little more difficult to—we believe it will be a little more difficult to generate a positive cost benefit. We are not saying that it can't be done, but we are saying that it will be more difficult in a low cost State for obvious reasons.

And going back to the mandatory participation in RTOs, it becomes particularly difficult for us to be mandated into an RTO that has a negative cost benefit.

Mr. NORWOOD. So in a State like ours, we have to be a little bit concerned, because apparently I think Georgia is doing pretty well, and that if we aren't very, very careful some of these good ideas are going to end up costing our rate payers more money.

Mr. JOHNSTON. They may.

Mr. NORWOOD. As we talk of moving into a new system, and market place for electricity, I would like for you to take a minute and tell us how all of this will effect my 48 cities in Georgia about tax exempt financing?

Mr. JOHNSTON. Well, the tax laws for a long time, both Alan and myself, and many others, have insisted that the tax laws, and the private use provisions of the tax laws, has got to be changed, or it is essentially a non-starter for us.

We can't enter the RTOs and offer up our assets under the current provisions because we would violate those tax laws. Those have got to be changed as a prerequisite to entering RTOs, even if the RTOs are cost beneficial.

Mr. NORWOOD. Those tax laws are fairly new aren't they? I mean, it hasn't always—that has been a change for you, the tax law itself; is that not correct?

Mr. JOHNSTON. There is a current tax law that is still in a temporary form, I believe, but you could make that permanent, but that does not take care of all of the issues that we have under the tax code. It is the 1987 tax law that actually applies today, but we still need to make revisions to that effectively in our RTOs.

Mr. NORWOOD. The red light is on. I am certainly not through, and Mr. English, I am going to get into this with you in just a little bit in the next round on the RTOs. But at this time—well, who is next? Well, Ms. McCarthy, I believe you are next for 5 minutes.

Ms. MCCARTHY. Thank you very much, Mr. Chairman, and I thank the panels for their expertise here today. PUHCA has been amended three times, and I know that you are aware of that, by the Congress to permit diversification into independent power in telecommunications and foreign utility companies.

But each time this committee has okayed an exemption, it has ensured that the State Regulators had a role in approving the diversification or the letter of investment, particularly whenever State regulated existing utility assets could be involved in the new venture.

This bill before us repeals PUHCA without any similar State role. I am a former State legislator. So, for full disclosure, I am coming from that particular point of view.

So it just gives the States the right to see the books, and the records of the company.

But in light of Enron, is this enough. And also following up on an issue that Representative Waxman raised earlier with regard to if PUHCA is eliminated that the negative effect of that on renewables, I wonder if you would speak to what extent that there should be incentives or a renewable portfolio standard in any comprehensive electricity restructuring legislation.

And also what you think would be a realistic goal for a RPS by the year 2010 or 2020, so that we could have those thoughts in mind. And I would welcome a response from any of the panelists on both of those questions. Mr. Sokol.

Mr. SOKOL. Mine is specifically on PUHCA. The assurances that Congress has received in the past were in fact accurate. That the States do in fact have access to stop the types of diversification, et cetera, within the State regulated utility.

That would be unchanged under 3406, as well as in the Bingamam and Daschle Senate bill, because PUHCA is merely the books and records, and affiliate issues would actually be expanded at the State level to all utilities today, and books, records and affiliate abuse activities only are available to PUHCA companies.

Those that aren't—as an example, Portland General Electric, which is owned by Enron, is not subject to the Act. So what this Act would do is actually expand that books and records authority to every State.

And as I mentioned before, one of the most important points that I think to recognize in Enron is that the only new assets that Enron has that aren't of any substance that aren't bankrupt today is Portland General Electric and its interstate pipeline gas activities. And that is because both of those were protected by State regulations, and not by PUHCA.

Ms. MCCARTHY. I think that I want to clarify where I am coming from in this question. Yes, I think the expanded involvement with the books and assets, and all of that is important.

But the fact that the State regulators will no longer have a role in approving diversification nor the level of investment was what the thrust of my question was about; and, yes, it is nice that they can go out and examine those things, and that has been expanded.

Mr. SOKOL. But States do have the ability to stop—and as an example. The reason Enron was not able to make a mess out of Portland General Electric is the State didn't let them. Enron could not pledge the assets of Portland General Electric.

It could not borrow money to use in its derivative activities against those assets because of State regulation, and not because of PUHCA. The only thing that PUHCA does today is that it stops companies like ourselves, a Triple-A rated company, Burcher-Hathaway, from investing in the industry.

It does not stop a utility from making bad decisions at its holding company level elsewhere in the industry, and I think that is a key distinction.

Mr. ACQUARD. Congresswoman, if I may jump in here.

Ms. MCCARTHY. Yes, please.

Mr. ACQUARD. I agree with my friend that the Public Utility Holding Company Act would not have prevented the Enron situation, but I think it is very clear or I think it is clear that what it did prevent was the Enron situation getting worse.

And I say that because the Public Utility Holding Company Act helps structure the industry to encourage single-State systems, and not multi-State systems. And once you get into a multi-State system—for example, if the Enron Company had purchased another utility, the Holding Company Act would have kicked in.

Now, I don't know what their business plan was, but I would guarantee you, or I can almost guarantee you that they did not get into other utilities because they did not want to get covered by the Public Utility Holding Company Act.

And there are many ramifications of that, one of which is non-energy related businesses they would have to sell off. So if they were involved in any non-energy related businesses, if they purchased a second utility, then they would have had to have spent off some of the other businesses.

So it is not so much—the beauty of the Public Utility Holding Company Act is not what it does. It's what it prevents from being done.

Ms. MCCARTHY. I think that was my concern all along, because in a multi-State Holding Company, how does the State control that big company if we eliminate PUHCA? And I very much appreciate your response to that.

I would also like to hear your thoughts on renewables if we eliminate PUHCA. What kind of portfolio should we have, and how do we put incentives in to make sure that we have reached reasonable goals in 2010 and 2020?

It is a part of the solution that we seek for energy security in this Nation, and that we get off our dependence on imports and we start looking at renewables. And in particularly in electric utility restructuring the obvious has been studied and is there, and on a small scale happening, and so how do we increase that by incentives if we are going to eliminate PUHCA?

Mr. ACQUARD. Well, again, as perhaps wanting to be heard on this, as one of the largest renewable energy generators in the world, PUHCA has not either helped or inhibited renewable generation because it is a non-regulated entity.

And we have just announced an expansion of 170 megawatts of our renewable energy in California, and we have well over a thousand megawatts of renewables around the world. PURPA on the other hand, on a prospective basis being removed, we don't believe—and again as one of the largest players in the industry, we don't believe that it will in fact slow down renewable generation as long as open transmission access is in fact achieved through a bill like 3406.

So that we actually have the right to get on to the grid system and utilize the grid system with fair and reasonable rates. We would certainly be in favor of a renewable utilization standard, either in the State level or the Federal level. But since it would be self-benefiting, I probably should not give a level.

Ms. MCCARTHY. Do you have an estimate on goals in 2010 and 2020, realistic goals?

Mr. SOKOL. Realistic goals on the order of 6 to 7 percent would be certainly encouragable.

Mr. NORWOOD [presiding]. Thank you, Ms. McCarthy. Your time has expired.

Ms. MCCARTHY. I'm sorry, Mr. Chairman. You have been most gracious.

Mr. NORWOOD. That's all right. I understand.

Ms. MCCARTHY. I thank you very much.

Mr. NORWOOD. The gentleman from Oklahoma is now recognized, Mr. Largent, for 5 minutes.

Mr. LARGENT. Thank you, Mr. Chairman. As one who has been following this debate for a number of years, it is interesting to me to hear a number of our panelists in their testimony this morning.

It seems like not that long ago that we were hearing that whatever we do in restructuring that we don't hand FERC too much authority, and that is a very bad thing. And maybe that was a Hecker-lead FERC, and we don't want to give them too much authority.

And now it is a Pat Woods led FERC, and we are hearing don't be too prescriptive to FERC on how RTOs are formed, and so and so forth. And it used to be that when we started talking about a comprehensive restructuring bill that we could click off about 3 or 4 things that there was fairly broad agreement on.

And like right out of the bat it was PUHCA and repeal. Done. Interconnection. Done. Reliability standards. Done. Those were like the easy things. Now, let's get into the harder things, in RTO formations, and so on and so forth. Transmission.

And now we are back to where the PUHCA repeal is even controversial. I mean, there is a number of our panelists who have testified that it is a bad thing that we repealed PUHCA.

I guess my question that I don't have for any specific panelist, but I would be glad to listen to, is why now that we don't want to be too prescriptive when we talk about RTO formations.

Why shouldn't that be the responsibility of Congress? Lynne?

Ms. CHURCH. Well, Mr. Largent, I think that FERC already has a tremendous amount of jurisdiction, although there are challenges to that jurisdiction, to enable the markets to go forward, and to enable the establishment of RTOs.

And while we have always encouraged making sure that FERC had adequate jurisdiction, I think now what is being seen by some who are opposed to a competitive market is that FERC is really trying to exercise that authority.

And now there is pushback from those who really do not want to see that exercise done. I think that has resulted in this reversal.

Mr. LARGENT. But at the same time, you are just one election away from seeing that change again potentially, right? I mean, why wouldn't you just want to statutorily say this is how we are going to form RTOs and this is what they should look like?

Ms. CHURCH. I don't want to statutorily say that.

Mr. LARGENT [presiding]. I know. I am saying why don't you?

Ms. CHURCH. Because I believe that FERC, even under Chairman Hecker, and certainly under Chairman Moeller, and under Chairman Hébert, and now Chairman Wood, have all agreed that we have to move forward.

And they have all tried in various ways, and dependent upon what the atmosphere was at that time, to move forward toward setting up RTOs in really regional vibrant markets. I think the circumstances both in the industry and in the make-up of the Commission, and in the make-up of Congress, have changed enough that now we are seeing a recognition that FERC has a tremendous amount of authority and expertise, and perhaps they should be doing or exercising that themselves without a lot of restrictions.

But at the same time, we are now seeing the push back I think from those who are really concerned about their exercise of that jurisdiction.

Mr. LARGENT. Well, the other question that I had was—and this is a little bit baffling to me, too—that I know that we have had panelists here just this year that have come and testified, Goldman Sachs and so far, and saying that one of the reasons that new transmission is not being constructed is because there is incentive to do that.

That the rate of return that is allowed by FERC is not high enough, and so that is kind of what has spawned the incentive-based rate. Everybody is shaking their head like that didn't happen. I was right here and the gentleman was sitting in that chair who said it.

He maybe wasn't from Goldman Sachs, but that was what he said, and we can get the testimony from anyone who wants to disagree with me. But anybody have any comments on why incentive-based rates won't be helpful in building new transmission in this country?

Ms. CHURCH. Well, if I could just follow up on that one as well. I think incentive rates have a role, and I think FERC has adequate authority right now to decide when it would be appropriate.

But I think the main reason that we have not seen more transmission bills was the uncertainty of what was going to happen in the markets, and whether or not RTOs are going to be put in place, and how quickly.

And so that uncertainty has had a cost, and second, of course, the siting issues. That while no one has been able to cite a case here where a State has turned down a transmission grid, we know that getting a transmission line sited is very, very difficult, and very time consuming.

And to the extent that it could be expedited by having a fallback from FERC to exercise some authority, I think that it would be very helpful.

Mr. LARGENT. Anybody else want to comment?

Mr. SOKOL. Yes, sir. Congressman, I think the issue of incentive rates really kind of fall into two categories, and it is about definition of who is going to determine the need for the asset.

And if in today in our service territory, or I think in any municipal service territory, if for us to service our customers we need a transmission line, we build it, and we find a way to get it sited and we get it built.

The question is that with a national grid system, where there are pieces of the system that need to be built to help a lot of folks, and not necessarily my customers, if you are going to leave the rules unclear, you are going to have to incentivize somebody to come in and take the risk that it will get used.

Or you are going to have to have a body that determines its need and determines how it is going to get paid for. If you do the latter, capital will show up to do that. But it is a bit like adding a lane on to an interstate. Is it for everybody's good, and then who pays for it, or are you going to make it a toll road.

Most likely the person that puts in the toll road will expect a higher return because he is running the risk that it will get used. And I think we are going to need a mixture of those two, but either will solve the problem.

A good portion of which really should be just resolved by having the rules set out so that FERC, or an RTO, or someone can determine the need, and assess the costs reasonably to all the parties involved in the RTO, and build it. That capital will be there if those rules are clear.

Mr. LARGENT. Mr. English.

Mr. ENGLISH. In answer to your previous question, I think with regard to the FERC issue, basically what it comes down to is that this legislation is trying to regulate the regulators, and I don't think that you can do that very well through the legislative language.

You may be able to do that with the administration of programs, but if you have got regulators out there and you don't like what they are doing, and you want to regulate in their place, then you ought to get rid of them.

And Congress can try to regulate directly. I don't think that is going to work, but that would be the approach. If you look at this, this is Congress trying to tell FERC that you have got to do this or you have got to do that.

I would suggest to you that if that is what this committee wants to do, it would be far more appropriate, and far more effective, and certainly better for the Nation, if you simply called FERC up here and tell them this is what we think you ought to be doing.

But to eliminate their discretion and to tell them specifically what you are going to do, then you are trying to take their place, and you are trying to regulate for them.

Now, we have had—I would totally agree with you that you have serious disagreements, depending on who the Commissioners are and what actions are taken.

You know, we have disagreed with some, and in some cases we thought they were doing a great job. And they are making their call, but that's the reason that I think that it is far more appropriate to express displeasure in that manner rather than through legislation.

Mr. LARGENT. Mr. Acquard.

Mr. ACQUARD. Just to give you a real world example. A couple of weeks ago we had our annual conference up on Philadelphia, and my folks traveled out to PJM, which many consider one of the most successful operating RTOs today.

And one of the questions that my members asked was do you need incentive rates and siting authority to do your job, and they said absolutely not. We are operating properly without them. So the short answer to your question is that they are not needed.

Mr. LARGENT. Well, I guess my only argument to that, and specific to that area of the country, is that it took—and I think that this is fairly analogous, is that it took forever to get another natural gas pipeline built to the northeast part of the country because of all of these issues that we are talking about, and that we are trying to address in electricity.

So it is an issue. I mean, they can tell you that it is not a problem to deal within their RTO, but when you are trying to connect hopefully what will be a national power grid, that's where the problem comes in, and that is what we are supposed to be dealing with.

We are not supposed to be getting into what happens in the State of Pennsylvania. That's Pennsylvania's issue. What we are talking about is making sure that we have an interconnected national bulk power grid.

Mr. ACQUARD. And then didn't think that was a problem either.

Mr. LARGENT. Well, I can tell you that there is a lot of people that are having trouble moving power across their grid that would disagree with that. Mr. Chairman, I yield back.

Mr. NORWOOD [presiding]. Thank you, Mr. Largent. Mr. Wynn, you are now recognized.

Mr. WYNN. Thank you, Mr. Chairman, and I thank the panelists for coming here today. Let me ask first kind of a general question. Is there anyone on the panel who strongly opposes bidding out the construction of new facilities? Is there anyone that says that that is a real problem?

Mr. JOHNSTON. As a matter of fact, the southeast SeTrans model that we are negotiating with the other Southeast utilities does just that.

Mr. WYNN. Okay. Great. The next question is that I believe that it was Mr. Richardson who said that he felt that in terms of incentive pricing that FERC had enough authority under just and reasonable to accommodate the concerns that were raised.

Apparently, Mr. Sokol, do you disagree with that? I don't want to kind of point a finger at you, but I just wanted to find out if there was disagreement with that analysis?

Mr. SOKOL. Under the historic structure, no, I don't disagree.

Mr. WYNN. Is there anyone that feels strongly that we should not grandfather in State and net metering?

[No response.]

Mr. WYNN. I believe, Mr. Richardson, that you said that there needed to be—that in the absence of PUHCA, there was at least some momentum toward repealing PUHCA, but in the absence of PUHCA, there needed to be some market or some protection for consumers against abusive market power. What did you have in mind?

Mr. RICHARDSON. Well, first of all, just to clarify a point earlier. APPA at least has been consistently opposing or has been acknowledging the fact that the modifications of the Public Utility Holding Company Act are probably in the cards in this debate over industry restructuring.

So in that sense there has been a consensus that the Holding Company Act is an issue that needs to be addressed, but repeal is not something that we have supported. And in fact, as you said, we have endorsed the proposition that if you are going to take away the consumer protection provisions of the Holding Company Act that they need to be replaced by something else.

And the something else is that those other things need to be expanded in FERC authority in dealing with the holding company mergers, in addition to the authority that FERC already has; and a reexamination of the standards under which FERC examines mergers.

Perhaps the preservation of the authority to disband the holding company and the so-called death sentence provision of the holding company. If it is found that a holding company is operating utilities or operating in ways that are detrimental to the interests of consumers, as well as other market power provisions that we have identified in previous testimony.

Mr. WYNN. I appreciate that, and if I could impose upon you, or have someone from your group send me those alternatives in writing, I would appreciate that.

Mr. RICHARDSON. We would be happy to. There is a number of other issues; affiliate abuse, protections, and so forth, and I would be happy to do that.

Mr. WYNN. I would like to get that. Also, I believe you said that you believe that in terms of access to records that it is too narrowly drawn with respect to only costs. What additional government records do you believe that Federal regulators ought to have beyond the, quote, costs?

Mr. RICHARDSON. It appears to us that the access to books and records, assuming that the State Commissions are not asleep at the switch and are doing what needs to be done to look at the books and records, the provisions allow them to look at books and records only with respect to rates charged.

Now, how broad is that or how narrow is that, that's an issue that certainly would be subject to interpretation, but it is not clear to me that it goes all the way to affiliate transactions, and potentials for affiliate abuses.

Transactions to the holding companies, and structure, and the financial posture and structure of the holding company itself rests over on top of the operating utilities.

So it is not clear that all of those books and records that have to do with the operations of the holding company actually could be obtained under the provisions that are in this provision.

Mr. WYNN. If I could impose upon you again to provide me with that information, I would appreciate it.

Mr. RICHARDSON. I would be happy to.

Mr. WYNN. I won't impose again, but I thought that was useful. Now, I guess the final point that I would just make is that we are giving or proposing to give FERC broad authority, but it seems like we are narrowly construing the authority in that critical area.

So I think that it is important that we have the maximum ability to look at all of the records. The imposition of wholesale strategy and costs by FERC; I have a concern about that. Is there anyone that has a concern about whether or not States ought to be——

Mr. RICHARDSON. Well, if you are referring to the section on the wholesale costs for——

Mr. WYNN. Right.

Mr. RICHARDSON. In cases where communities would like to establish their municipal electric utility system, we are very concerned about that. That is a provision that is in our view completely unnecessary, and would make the creation of new public power systems, or even the exploration of new public power systems cost prohibitive.

States have the authority to deal with this issue, and FERC is a back stop to deal with this issue on a case-by-case basis. Additional legislation is not necessary. In fact, it is counterproductive.

Mr. WYNN. Thank you very much. I see that my time is up. Thank you, Mr. Chairman.

Mr. NORWOOD. Thank you, Mr. Wynn. Mr. Markey, you are now recognized.

Mr. MARKEY. Thank you, Mr. Chairman, very much. Mr. Richardson, if Enron had been an SEC regulated registered holding company, it would have had to have undergone prior SEC review of its corporate and capital structure, including its equity, its debt, and its relationships with its affiliates; is that right?

Mr. RICHARDSON. That's correct.

Mr. MARKEY. Now, do you think that the SEC would have granted prior approval to the types of disclosure documents, capital structures, and insider deals with all of those shadowy partnerships that we have been reading about?

Mr. RICHARDSON. It seems unlikely.

Mr. MARKEY. Now, PUHCA also restricts the ability of registers to diversified into unregulated business areas; isn't that correct?

Mr. RICHARDSON. Yes, it is.

Mr. MARKEY. And even in those areas where Congress has authorized some diversifications—exempt wholesale generation, foreign utility investments, telecommunications—that Congress has placed certain restrictions on such investments in order to protect utility operating companies from failed diversifications; is that right?

Mr. RICHARDSON. Yes, they have.

Mr. MARKEY. Now, your testimony suggests that the only real benefit of repealing PUHCA is that it allows large multi-State utility holding companies to merge and grow even larger by acquiring operating utility companies all over the country, and to diversify into other non-utility businesses; is that correct?

Mr. RICHARDSON. Yes.

Mr. MARKEY. So if we do what H.R. 3406 recommends, what is to prevent the next Enron from being a large utility holding company and the bankruptcy of that company from harming utility consumers in a crisis far worse than the collapse of Enron?

Mr. RICHARDSON. In my view, very little, and I think that is the point that Mr. Dingell was making earlier today about what if the Act were repealed and Enron were to become a holding company.

Mr. MARKEY. Well, great minds think alike.

Mr. RICHARDSON. Yes, they do, sir.

Mr. MARKEY. If I can restate that now. Now, Mr. Sokol, the SEC was not regulating Enron on-line as a broker dealer; isn't that correct?

Mr. SOKOL. Nor as a public utility holding company.

Mr. MARKEY. So, Enron on-line was not subject to the provisions of the Securities Exchange Act that are normally applicable to broker dealers, and these include holding company risk assessment, large trader reporting, capital rules, margin requirements, audit trails, broker-dealer record keeping, front running, and other anti-manipulation and anti-fraud rules.

So, Enron was not subject to any of those rules as far as I understand the situation.

Mr. SOKOL. Well, first of all, Congressman, as you know, I am not a defender of Enron by any stretch of the imagination. But I believe that Enron is subject to the rules of every public company, and of proper disclosure of its financials, and proper and full disclosure to its investors of the risks, and all information necessary for intelligent investment decisions.

And so I think certainly a large portion of the SEC rules, Enron was subject to, and should have been responding to.

Mr. MARKEY. Well, do you think that this subcommittee should consider regulating the over-the-counter markets in which Enron operated, including both the markets for physical delivery of electricity and the OTC electricity derivatives markets?

Mr. SOKOL. I think it definitely at a minimum should hold hearings and very seriously look at those issues, in addition to potentially revamping the methods for the criminal and civil penalties for improper disclosure, both for company management, as well as auditors.

Mr. MARKEY. Do you agree that if we repeal PUHCA that we need to retain and strengthen FERC's merger review authority so that the market power issues are dealt with?

Mr. SOKOL. Well, I think first of all that PUHCA clearly should be repealed, and as you said yourself, and I think Congressman Dingell indirectly as well, PUHCA did absolutely nothing.

In fact, in many ways as Congressman Sawyer said, PUHCA allowed an Enron to exist, and it in no way resisted it. As to merger powers, we are completely fine with FERC's review of mergers.

There are redundant merger review processes, and the only request we would have is merely that there be some level of time commitment to review them in a prompt way and make a decision. But market power issues clearly should be a major consideration in those reviews.

Mr. MARKEY. Does anyone on the panel think that FERC should not have strengthened review powers over mergers if PUHCA is repealed?

[No response.]

Mr. MARKEY. Earlier on, Mr. Sokol, you said that what Enron had done with respect to its accounting practices, its off-balance sheet items, and its special purpose limited partnerships, is not unique in the energy business. How widespread are these practices?

Mr. SOKOL. Well, I would say that of companies like Enron, and again the non-regulated sides of the business, it is more widespread certainly than is helpful. I think we are already seeing other companies unwind similar activities.

Mr. MARKEY. Well, what other companies are doing that right now?

Mr. SOKOL. Well, yesterday, El Paso announced that it would unwind two of its off-balance sheet partnerships that were very similar to what Enron had. Again, El Paso is not a Public Utility Holding Company Act company, and PUHCA did not in any way prohibit them.

And I believe that there are other folks in that sector that have used accounting treatments that perhaps shouldn't be used in the future.

Mr. MARKEY. Okay. And, Mr. English, Glenn, back when you served in Congress, you had jurisdiction over the CFTC over there at the Agriculture Committee, and during that time you may recall that Congress passed the Futures Trading Practices Act of 1992.

And that authorized the CFTC to exempt over-the-counter derivatives from regulation as futures, and this exemption was fur-

ther expanded during the last Congress when we passed the Commodity Futures Modernization Act.

Now as a result of those laws, the CFTC has virtually no jurisdiction over the OTC derivative markets, and hence over the activities of companies like Enron.

Mr. ENGLISH. Well, I hope that you also remember when I was chairing that subcommittee that I strongly objected to that and felt that those derivatives should be regulated.

Mr. MARKEY. Well, I am ready to serve up the great truth. Let me finish. I have the big home run pitch coming.

Mr. ENGLISH. Okay. Don't make it too slow now.

Mr. MARKEY. Okay. I have to try and speak as slowly as they do in the Southwest right now in setting up this pitch. So in light of that, do you think we should consider giving FERC additional authority over electricity trading markets and related derivative markets so that there is some Federal regulation over these things in view of the fact that at that time you had great reservations about granting those exemptions?

Mr. ENGLISH. And given that previous experience, I would say whole-heartedly, yes. I don't think there is any question that we need to focus more attention on these derivative devices that are used to in effect evade any kind of oversight, and that is basically what we are talking about here.

Mr. MARKEY. Does anyone on the panel disagree with Mr. English?

Ms. CHURCH. Yes, sir.

Mr. MARKEY. Okay.

Ms. CHURCH. While I am not suggesting that it is inappropriate for certainly Congress and the regulators to relook at the issue, I would just strongly remind the Congressman and the rest of the panel that Enron's core business of electricity trading—their platform, and their other trading—was not what brought them down.

It was not their problem. Their problem was in their debt leverage and in their disclosure process. In fact, their trading was in fact their crown jewel, which was providing the cash-flow, and ultimately it was the discipline of that trading market and the fact that the counter-parties lost confidence in Enron's financial status.

Mr. MARKEY. So, what you are saying here for the record then is that none of the debt, none of the problems, were in any way related to the trading practices that were going on. You are ready to go on the record and say that?

Ms. CHURCH. Yes.

Mr. MARKEY. None of it?

Ms. CHURCH. Yes, that is my understanding.

Mr. MARKEY. So what did cause it, just so we can all understand it if it wasn't that?

Ms. CHURCH. I think it was a lack of financial confidence that was due to their disclosure about the level of debt which was not what had been known before. And particularly in their off-balance sheet partnerships, and the fact that there was increasing concern about their disclosure in their financial statements. That is what started the spiral eventually that I think brought them under.

Mr. MARKEY. I thank you, Mr. Chairman, for your tolerance. I would just say that I think that a lot of their bad debt was related to obviously this diversification strategy in my opinion.

And obviously derivators in the words of many people on Wall Street are really just like nuclear weapons out there; and that if not understood—and we know that there isn't a single CEO in America that I know of that really understands derivatives, which is why the higher 27 year olds that went to MIT, and who go summa cum laude degrees in advanced math, and so they really don't understand them.

So to say that they are over here in this OTC derivatives marketplace, and somehow or other the marketplace will work out, with no oversight whatsoever, I think is a very dangerous game to play. And I thank you, Mr. Chairman.

Mr. NORWOOD. Yes, sir, Mr. Markey, and let the record show that to get back into your good graces you got 10 minutes of questioning done.

Mr. MARKEY. I thank you, Mr. Chairman.

Mr. NORWOOD. If the panel would indulge us, we would like to ask a couple of more questions, and in a very limited time, to 3 minutes, and if we can have that understanding, I am going to slam the gavel down in 3 minutes.

And so if you would be kind enough to answer just a couple of more questions. Mr. Walden, you have 3 minutes.

Mr. Walden. Well, Mr. Chairman, for your good graces, I would like 13, but I will take three. I wanted to follow up on PURPA because we have heard about it from the perspective of its importance to spawn these alternative energy production facilities.

But isn't there another side to PURPA? I mean, I have got a few of those contracts in my district, and for 3 years I have heard from some of those who have been "stuck" with them from the buying side, and that it has been a burden on consumers, and on the rate payers because the rate was higher than the market and they were locked into those agreements.

Can you speak to that, because I think we have got to get a balance here on making sure that the renewables that we put on-line are affordable to the rate payers.

Ms. CHURCH. I will speak to PURPA if I may. I think the mandatory requirement to buy that is in the bill really no longer makes a lot of sense in this market.

Mr. Walden. You mean in the law?

Ms. CHURCH. In the law.

Mr. Walden. Not in the bill?

Ms. CHURCH. Sorry, not in the bill. Correct. The law currently has a mandatory take requirement from utilities, and in this day and age, and in this type of market, that really does not make sense.

And we have not opposed eliminating prospectively the must-take provision. There is one problem with the bills dealing with PURPA, in that it does not eliminate the ownership restrictions that are also currently in the bill. Excuse me, currently in the law.

But generally PURPA—has PURPA really spawned the competitive industry? I think it has had a great deal of success in bringing

renewable facilities on-line, and I think it will continue, but I think that the must-take provision no longer makes sense.

Mr. Walden. Another topic is that we have heard a lot about Enron's problems, and how once their revenues were recalculated and their off-balance sheet debt was brought into play, and then it all began to link to one another, and as the debt appeared to increase, it triggered other requirements.

And then the credit ratings went down, and it just got away like a chain reaction. Then I noticed in the news recently that California is saying that they want to renegotiate the contracts for power that they just entered into earlier this year, which triggered some companies to begin to put forward that their revenues might be less than anticipated if that occurs.

And as a result, I think it was Cal-Plan if I have got this right, and their stock began to tumble. Can any of you speak to what is going on in California, because we spent all spring trying to figure out what it was, and then about the time the market started to correct, they decided to enter into long-term agreements.

And I predicted then that they would be back once the market straightened out complaining about these horrible long-term agreements that they were "forced" to enter into.

Are we now beginning to see a sort of new bludgeoning over these agreements?

Ms. CHURCH. Yes, sir, I believe you are, and we are unfortunately. The powers that be in California took the correct step in January and February when they entered into long term contracts to supply most of the power.

Unfortunately, their timing was terrible. It was much too late, and——

Mr. Walden. After they had denied the utilities the ability to do the same thing within a prior year period, right?

Ms. CHURCH. That's correct.

Mr. Walden. So they entered the market at the wrong time and into agreements that were long?

Ms. CHURCH. That's correct. There were suppliers publicly offering the utilities long-term contracts at 5 cents, and 5½ cents, or 6 cents, in the summer of 2000.

And had those utilities been allowed by the State Regulators at that time and the State Legislature to do that, we would not have been in the situation we were.

The Governors group bought at the top of the market, and those are contracts that are bilateral contracts. They are enforceable contracts. I have heard many of the suppliers say that they are willing to discuss renegotiating those contracts if it results in mutually beneficial results.

But those are enforceable contracts, but they in hindsight, the Governor moved too slowly.

Mr. NORWOOD. Thank you, Mr. Walden. Your time is up. Sorry, gentlemen. Mr. Boucher, you are recognized for 3 minutes.

Mr. BOUCHER. Thank you, Mr. Chairman. I have one question, and Mr. Acquard, I will pose this to you. Those who are advocating a removal of the Federal Energy Regulatory Commissions' authority to review mergers argue that the function of promoting competition can be performed very adequately by the Department of Jus-

tice, or the Federal Trade Commission, one or the other of which would have jurisdiction in the event of mergers.

Tell me—and this is for the benefit of the record, which we will share with other members. What is it that the FERC can do, and is uniquely positioned to do that these anti-trust enforcement agencies are not?

Mr. ACQUARD. I think basically that they have an understanding of the energy industry. The FTC and the Department of Justice does not have that understanding. So we believe that it is important that FERC continue to have a role in those mergers.

The concern ultimately is that unless you take a close look at the mergers, and you have added authority on mergers, that we are going to turn into a Bell system, turning to the telecommunications area, where we will have fewer and fewer competitors, and we will not have an agency that fully understands the industry that they are regulating.

Mr. BOUCHER. So FERC has special knowledge which can and is brought to bear on merger reviews?

Mr. ACQUARD. Absolutely.

Mr. BOUCHER. A deeper knowledge than the anti-trust agencies possess?

Mr. ACQUARD. Absolutely.

Mr. BOUCHER. And FERC can utilize this knowledge to promote competition more effectively than the anti-trust review can promote it?

Mr. ACQUARD. That's correct.

Mr. BOUCHER. Thank you, Mr. Acquard, and thank you, Mr. Chairman.

Mr. NORWOOD. Thank you, Mr. Boucher. I recognize myself for 3 minutes. Mr. Johnson, you have 48 cities in your association in Georgia. Now, over the past 20 to 25 years how much money has your operation spent in investing in transmission infrastructure to serve those customers?

Mr. JOHNSTON. We have between $300 and $400 million of tax exempt bond investment in transmission in Georgia.

Mr. NORWOOD. And under this new system are you going to be able to guarantee those customers that they will not experience a brown-out when merchant plants in other States sell and transfer electricity through Georgia transmission systems, and say up to Mr. Markey's area?

Mr. JOHNSTON. Not unless we can successfully negotiate a native load protection provision that we are negotiating. But without that, we would not be able to guarantee delivery, no.

Mr. NORWOOD. Now, if you have brown-outs and you can't guarantee that delivery, who are we going to holler at? Are we going to be mad at you or are we going to be mad at the RTO?

Mr. JOHNSTON. Well, I know that there is going to be a lot of hollering going on, and I probably have plenty of it directed to me, and there will probably be plenty of it directed at you and others.

Mr. NORWOOD. Well, Congressman Barton just pointed out that they would be hollering at me, too. So, you seem to think that the rate payers, the native load customers, should be given some kind of priority consideration?

Mr. JOHNSTON. Yes, because frankly they have paid for that system, and they are subject to the bond debt for the life of that debt, and why shouldn't they have priority. It was built for them.

Mr. NORWOOD. You are talking about incentives that Congressman Largent was talking about. Had you known years ago that this $300 to $400 million that you had invested in transmission lines were going to be taken away from you and perhaps you could only use it when somebody else says you could use it, would you have had an incentive to build that transmission line?

Mr. JOHNSTON. No, we would not.

Mr. NORWOOD. And if we do have RTOs, there had better be some incentives for new transmission?

Mr. JOHNSTON. Yes.

Mr. NORWOOD. And it needs to be incentives that we think will last a few years and not be taken away as we might be talking about doing that now, and with that, I yield back the balance of my time, and I yield the chair to the dcairman.

Mr. BARTON. Thank you. I am not going to ask any questions. It is 1:15 and I could debate with each of you and say something funny, and you could come back with something smart, and all of that.

We know where you are, and we appreciate you being here. We have been messing with this issue for—you could say for the last 10 years. We certainly have been trying to do something for the last seven, and I have been trying to do something for the last three.

The bill before us is not a perfect bill, but it is a real attempt at a balanced approach that tries to balance all the concerns that you put on the table. We are going to continue to work with you. I don't think some of you are as opposed to the bill as you have said today based on what you have said off the record.

But I am not going to put you on the record when you said to keep it off the record. I am going to check with Chairman Tauzin. It looks like the House is going to be in session next week. We are coming in at 6:30 next Wednesday, and we will be here all day Thursday.

My intention is to schedule opening statements on the mark-up Wednesday afternoon late, probably about four o'clock, and then go to mark-up on Thursday. That is an intention, and that is not a declaration. I need to check that with the chairman, and obviously I need to check it with Mr. Boucher and Mr. Dingell.

I would like to get this bill out of the subcommittee next week if we have time to do it, so that we can set it up to go to the full committee. I really want this Congress to move a comprehensive electricity restructuring bill.

I think the time has come and I think we are close to consensus, and there will never be the perfect time. I mean, if we wait 6 months or a year, there is always going to be something else.

The only real alternative in my mind to doing something close to what we have got on the table would be a very slimmed down bill that just gave explicit authority to FERC to do what they wanted to do.

And in my opinion that is an abrogation of the Congress to legislate. The Congress legislates and the executive branch implements,

and too many Congresses have punted to the executive branch because we are not willing to make tough choices on issues that there is not total consensus.

So, I do appreciate each of you individually, and I do appreciate the groups that you represent. I would encourage you and your staffs to work with the member staffs and the leadership staffs on constructive ideas to perfect the bill, in terms of amendments and things that need to be added and deleted because it is now intention this afternoon to the opening statements next Wednesday, and go to mark-up on Thursday.

So I want to thank you for your attention and thank you for your participation, and with that, this hearing is adjourned.

[Whereupon, at 1:18 p.m., the subcommittee was adjourned.]